SELECTED READINGS
IN
MODERN ECONOMICS

PREFACE

Every teacher of economics consciously or unconsciously builds up a list of favorite readings and references which he believes contribute to good teaching because of their illustrative and stimulating value. Such a list usually contains material of a critical, descriptive, and historical nature, and current material of many types. Accordingly, the list as a whole will be representative of opposing points of view, and the selections will not necessarily be of the same weight, scholarship, maturity, logic, or significance. This is not surprising because the articles or books were originally addressed to different groups of readers and the speeches to a variety of listeners.

But any article or speech of economic import which promotes thought and sharpens the analytical power of the reader serves its purpose. Not infrequently, an article which irritates provokes more thought than one which fits comfortably into the accepted beliefs and preconceived notions of the reader.

Selected Readings in Modern Economics has been compiled with all this in mind. The problem of selection has been a question of what to leave out more than of what to include because of the hundreds of articles and books of significance. The editors have purposely omitted the articles readily available in the leading economic journals.

The material which has been included has been chosen with the following points in mind:

1. The growth of the field of economics, and the resultant growth in the size of textbooks, has made it necessary to omit certain material from the textbooks. Such material can be included in a book of readings.

2. A group of students might, in the ordinary course of events, use a textbook without having come in contact with the source material from which economics stems. A book of assorted readings helps to overcome this deficiency.

3. A textbook cannot give full attention to other schools of thought without interfering with the unity of the work. A book of readings, on the other hand, can call attention to conflicts, different points of view, etc.

4. A book of reading selections should encourage students to read further in the books from which the excerpts are taken.

5. Readings should lend color to the course material.

6. The readings should run parallel to the text rather than merely repeating, in other words, what is in the text.

7. Economic conditions are rapidly becoming more and more involved with government and law. Since economic development proceeds at a faster pace than law, the law occasionally tries to catch up. Sometimes this is done gradually, but sometimes, such as during the thirties, an attempt is made to take advantage of the economic slowdown to pass many new laws of a reform or other nature. Since legal thinking today seems to be in the ascendancy, it becomes necessary for the student of economics to take a renewed interest in contracts, legal aspects of business life, and legal decisions of all kinds pertaining to economic life. Selected readings can help to point up this need without interfering with economic analysis in the textbook itself.

Selected Readings in Modern Economics follows the organizational plan of *An Introduction to Modern Economics* (Robinson, Adams, and Dillin), but the readings themselves can be adapted to use with any representative text. This is suggested in the Guide to Representative Texts in Principles of Economics, which follows.

The editors wish to acknowledge with gratitude the help of Mr. B. F. Friedman, Instructor of Economics at the University of Pittsburgh, in preparing this volume. Specific acknowledgment to the owners of the copyrighted material reprinted herein is made at the end of the introduction to each Part.

ASHER ISAACS
C. W. MCKEE
R. E. SLESINGER

March, 1952

The following keys are furnished to show how the readings in this volume can be correlated with several standard textbooks in the field of economics:

GUIDE TO REPRESENTATIVE TEXTS IN PRINCIPLES OF ECONOMICS

Robinson, Adams, Dillin: AN INTRODUCTION TO MODERN ECONOMICS (*The Dryden Press, 1952*)

Isaacs, McKee, Slesinger: SELECTED READINGS IN MODERN ECONOMICS (*The Dryden Press, 1952*)

Textbook Chapters:	Reading Selections:
1–3	1–23
4–8	24–50
9–13	51–63
14–19	64–72
20–23	73–81
24–27	82–94
28–30	95–111
31–34	112–120
35–37	121–127
38–40	128–148
41–43	149–157

Burns, Neal, and Watson: MODERN ECONOMICS (*Harcourt, Brace, 1948*)

Chapters:	Readings:
1–2	1–23
3–7	24–32
8–11	51–63
12–23	73–81
24	22, 120
25–26	40–50
27	134–146
28–29	31–39
30	128–133
31–33	141–148
34–36	95–111
37–40	94, 121–127
41–42	149–157

Peterson: ECONOMICS (*Holt, 1949*)

Chapters:	Readings:
1–4	1–23
5–9	24–50
10–13	51–63, 111
14–16	82–92
17–23	64–72, 134–140
24–40	73–81
31	141–148
32	95–110
33	149–157

Waugh:
PRINCIPLES OF ECONOMICS
(*McGraw-Hill, 1947*)

Chapters:	Readings:
1–3	1–23
5	25
6–8	64–72
9	40–50
10	24–29
11	23, 117–120
12	30–32, 93, 94
13–17	64–72
18–21	51–63
22	82–92
23–24	95–111
25	137–140
26	115, 116
27	33–39
28	121–127
29	112–114
30–33	73–81
34–35	141–148
36	149–157

Samuelson:
ECONOMICS
(*McGraw-Hill, 1951*)

Chapters:	Readings:
1–3	1–23
4	93, 94
5	22, 71 112–114
6	40–50
7–8	141–148
9	31–39
10	94
11	82, 83
12	77, 78, 86, 93, 94
13	72–73
14–17	51–62
18	87–92
19	141–148
20–25	64–72
26–30	73–81
31–34	95–111
35	149–157

Ise:
ECONOMICS
(*Harper, 1951*)

Chapters:	Readings:
1	1–21
2–5	22, 23, 26, 27, 30–32
6	24
7–9	40–50
10	25, 93, 94,
11–20	64–72
21	48, 77, 87,
22–26	51–63, 87–92
27–29	95–111
30–36	73–81
37–38	141–148
39–40	24–29, 114, 119, 125–127
41–49	149–157

Kiekhofer:
ECONOMIC PRINCIPLES, PROBLEMS, POLICIES
(*Appleton-Century, 1951*)

Chapters:	Readings:
1	1–23
2–4	24–29
5	40–50
6–7	28, 29, 33–39
8	82–86
9–10	51–63
11–12	95–111
13–14	72
15–21	64–71
22–25	73–81
26	58–63
27	85–92
28	93, 94
29–31	121–127
32	30–32
33–36	95–111, 141–148
37–42	149–157

Morgan:
INTRODUCTION TO ECONOMICS
(*Prentice-Hall, 1950*)

Chapters:	Readings:
1	1, 4, 5, 11, 12, 17, 19, 20, 22, 30, 31
2	2, 3, 6–10, 13 18, 25, 26, 42
3	14–16, 21, 48
4	23, 24, 27–29, 41
5	43–47, 49, 50
6	122–124, 127
7–10	51–63
11–16	64–72
17	115, 116, 128–140
18–22	33–40, 73–81
23	125–127
24	141–143, 147, 148
25	82, 83
26	91
29	84–86, 121–124
30	31
31	144, 145
34	32
36	147, 148
38–39	95–111
40	125–127, 149–157

PART ONE

AN INTRODUCTION TO ECONOMIC THEORY AND ECONOMIC INSTITUTIONS

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PART THREE

MONEY AND BANKING

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DISTRIBUTION

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SELECTED READINGS

IN

MODERN ECONOMICS

PART ONE

An Introduction to Economic Theory and Economic Institutions

THE SELECTIONS chosen for this Part are intended to give the reader certain background material which will explain the nature of economics, economic theory, economic institutions, and economic method. Selection 1 is Alfred Marshall's account of the substance of economics and economic laws. Stephen Leacock's article (2), although written in a lighter vein, affords the opening challenge to anyone entering the field of economic study. The problems of economic terminology are described by Asher Isaacs in Article 3. Russell A. Dixon and E. Kingman Eberhart (4) explain the nature of "culture" as a background to the study of economics and economic institutions. In Selection 5, Harold G. Moulton gives the sources of economic development in the realms of both theory and industrial achievement. Selection 6 is a criticism of classical economic theory by J. M. Keynes. (By classical theory is meant the writings of Adam Smith, David Ricardo, John Stuart Mill, and others. These writings have had a profound effect from 1776 to the present day.) Selections 7, 8, and 9 present the institutional treatment of economics and are the works of John R. Commons, John S. Gambs, and Allan G. Gruchy, respectively. Arthur B. Adams' article (10) explains one of the devices used in economic analysis, the assumption of an equilibrium. Walter C.

Langer (11) offers a psychologist's analysis of a basic human want which underlies most human activity. Aristotle (12) gives the ancient opinion as to the nature of economics and money-making and throws some light on the living conditions of his period. The quotation from John Locke (13) shows the relation of private property and the concept of government. That from Justice Byles (14) shows the great degree of departure from the *laissez-faire* theory within the first century of its acceptance. C. H. Greenewalt (15) calls attention to the achievements of industrial research in the realm of human freedom. George Burton Hotchkiss (16) brings into bold relief the special-privilege nature of medieval trade, thereby making our present competitive system more understandable. Daniel Defoe (17), best known as the author of *Robinson Crusoe,* gives us a clear picture of the Stourbridge Fair, which flourished for almost 650 years, thus illustrating the nature of an institution of trade which played an important part in the development of commerce. Sir Geoffrey Heyworth (18) suggests the usefulness of a relatively new tool for economic and business analysis: statistics. Selection 19 gives a lighter glimpse into the retail business life of London in the eighteenth century and suggests that times have not changed very much insofar as human wants are concerned. The Reverend John Urmstone (20) paints a picture of the colonial labor shortage in 1711. Selection 21 questions the statement that there are no new economic frontiers left in the United States. Number 22 throws light on the general problem of conservation, particularly water conservation, in the United States, from the federal point of view. Douglas A. Fisher (23) describes the raw-material aspect of a basic industry, iron and steel.

Other selections which might be read in connection with this Part are Numbers 24, 25, 27, 30, 40, 41, 51, 52, 66, 81, 125, 127, and 156.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged below.

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(2) Leacock, Stephen, "Lost in the Jungle of Economics," *The New York Times Magazine,* August 20, 1939.

(3) Isaacs, Asher, Presidential Address before the Social Science Seminar, University of Pittsburgh, May 11, 1949.

(4) Dixon, Russell A. and E. Kingman Eberhart, *Economics and Social Change,* McGraw-Hill, 1938, pp. 5–9.

(5) Moulton, Harold G., *Controlling Factors in Economic Development,* The Brookings Institution, 1949, pp. 1–15, 29.

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(8) Gambs, John S., *Beyond Supply and Demand,* Columbia University Press, 1946, pp. 4, 13–14, 15–16, 18–19, 29–30, 32–33.

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(11) Langer, Walter C., *Psychology and Human Living,* Appleton-Century-Crofts, 1937, pp. 41–45.

(12) Aristotle, *Politics,* tr. by Benjamin Jowett, Oxford (England): Clarendon Press, 1923, pp. 38–41, 46.

(13) Locke, John, *Two Treatises on Government,* Morley's International Library.

(14) Byles, Sir John Barnard, "Sophisms of Free Trade Examined," from Friedrich List, *The National System of Political Economy,* tr. by S. S. Lloyd, Longmans, Green, 1928, Appendix B.

(15) Condensed from *The Story of Research,* E. J. duPont de Nemours & Co., and the Address of the Company's President, Crawford H. Greenewalt, May 10, 1951.

(16) Hotchkiss, George Burton, Introduction to John Wheeler, *A Treatise on Commerce,* New York University Press, 1931, pp. 23–29.

(17) Defoe, Daniel, reprinted from Keezer, Cutler and Garfield, *Problem Economics,* Harper, 1928, pp. 86–88.

(18) Heyworth, Sir Geoffrey, "The Use of Statistics," *Journal of the Royal Statistical Society,* Vol. CXIII, Part I, London, 1950.

(19) Reprinted from W. I. Howard, *English Social Life in the Eighteenth Century,* London: The Sheldon Press, 1928, p. 79.

(20) From a letter by Reverend John Urmstone, July 7, 1711. Reprinted from John R. Commons, *et al., A Documentary History of American Industrial Society,* Vol. II, A. H. Clark, 1910.

(21) *Monthly Letter on Economic Conditions,* New York: The National City Bank, February, 1951.

(22) *A Water Policy for the American People,* Report of the President's Water Resources Policy Commission, Government Printing Office, December, 1950.

(23) Fisher, Douglas A., *Steel-Making in America,* New York: U. S. Steel Corporation, 1949, pp. 29–32.

1

THE SUBSTANCE OF ECONOMICS AND ECONOMIC LAWS

ALFRED MARSHALL

ECONOMICS IS A STUDY OF MEN as they live and move and think in the ordinary business of life. But it concerns itself chiefly with those motives which affect, most powerfully and most steadily, man's conduct in the business part of his life. Everyone who is worth anything carries his higher nature with him into business; and, there as elsewhere, he is influenced by his personal affections, by his conceptions of duty and reverence for high ideals. And it is true that the best energies of the ablest inventors and organizers of improved methods and appliances are stimulated by a noble emulation more than by any love of wealth for its own sake. But, for all that, the steadiest motive to ordinary business work is the desire for the pay which is the material reward of work. The pay may be on its way to be spent selfishly or unselfishly, for noble or base ends; and here the variety of human nature comes into play. But the motive is supplied by a definite amount of money: and it is this definite and exact money measurement of the steadiest motives in business life which has enabled economics far to outrun every other branch of the study of man. Just as the chemist's fine balance has made chemistry more exact than most other physical sciences; so this economist's balance, rough and imperfect as it is, has made economics more exact than any other branch of social science. But of course economics cannot be compared with the exact physical sciences: for it deals with the ever-changing and subtle forces of human nature.

The advantage which economics has over other branches of social science appears then to arise from the fact that its special field of work

gives rather larger opportunities for exact methods than any other branch. It concerns itself chiefly with those desires, aspirations and other affections of human nature, the outward manifestations of which appear as incentives to action in such a form that the force or quantity of the incentives can be estimated and measured with some approach to accuracy; and which therefore are in some degree amenable to treatment by scientific machinery. An opening is made for the methods and the tests of science as soon as the force of a person's motives—*not* the motives themselves—can be approximately measured by the sum of money which he will just give up in order to secure a desired satisfaction; or again by the sum which is just required to induce him to undergo a certain fatigue

It is essential to note that the economist does not claim to measure any affection of the mind in itself, or directly; but only indirectly through its effect. No one can compare and measure accurately against one another even his own mental states at different times: and no one can measure the mental states of another at all except indirectly and conjecturally by their effects. Of course various affections belong to man's higher nature and others to his lower, and are thus different in kind. But, even if we confine our attention to mere physical pleasures and pains of the same kind, we find that they can only be compared indirectly by their effects. In fact, even this comparison is necessarily to some extent conjectural, unless they occur to the same person at the same time.

For instance the pleasures which two persons derive from smoking cannot be directly compared: nor can even those which the same person derives from it at different times. But if we find a man in doubt whether to spend a few pence on a cigar, or a cup of tea, or on riding home instead of walking home, then we may follow ordinary usage, and say that he expects from them equal pleasures.

If then we wish to compare even physical gratifications, we must do it not directly, but indirectly by the incentives which they afford to action. If the desires to secure either of two pleasures will induce people in similar circumstances each to do just an hour's extra work, or will induce men in the same rank of life and with the same means each to pay a shilling for it; we then may say that those pleasures are equal for our purposes, because the desires for them are equally strong incentives to action for persons under similar conditions.

Thus measuring a mental state, as men do in ordinary life, by its motor-force or the incentive which it affords to action, no new difficulty is introduced by the fact that some of the motives of which we have to take account belong to man's higher nature, and others to his lower.

For suppose that the person, whom we saw doubting between several little gratifications for himself, had thought after a while of a poor invalid whom he would pass on his way home; and had spent some time in making up his mind whether he would choose a physical gratification for himself, or would do a kindly act and rejoice in another's joy. As his desires turned now towards the one, now towards the other, there would be change in the quality of his mental states; and the philosopher is bound to study the nature of the change.

But the economist studies mental states rather through their manifestations than in themselves; and if he finds they afford evenly balanced incentives to action, he treats them *prima facie* as for his purpose equal. He follows indeed in a more patient and thoughtful way, and with greater precautions, what everybody is always doing every day in ordinary life. He does not attempt to weigh the real value of the higher affections of our nature against those of our lower: he does not balance the love for virtue against the desire for agreeable food. He estimates the incentives to action by their effects just in the same way as people do in common life. He follows the course of ordinary conversation, differing from it only in taking more precautions to make clear the limits of his knowledge as he goes. He reaches his provisional conclusions by observations of men in general under given conditions without attempting to fathom the mental and spiritual characteristics of individuals. But he does not ignore the mental and spiritual side of life. On the contrary, even for the narrower uses of economic studies, it is important to know whether the desires which prevail are such as will help to build up a strong and righteous character. And in the broader uses of those studies, when they are being applied to practical problems, the economist, like every one else, must concern himself with the ultimate aims of man, and take account of differences in real value between gratifications that are equally powerful incentives to action and have therefore equal economic measures. A study of these measures is only the starting-point of economics: but it is the starting-point.

* * * *

It is the business of economics, as of almost every other science, to collect facts, to arrange and interpret them, and to draw inferences from them. "Observation and description, definition and classification are the preparatory activities. But what we desire to reach thereby is a knowledge of the inter-dependence of economic phenomena. . . . Induction and deduction are both needed for scientific thought as the right and left foot are both needed for walking." The methods required for this twofold work are not peculiar to economics; they are

covery of the relations between cause and effect, which are described in treatises on scientific method, have to be used in their turn by the economist: there is not any one method of investigation which can properly be called the method of economics; but every method must be made serviceable in its proper place, either singly or in combination with others. And as the number of combinations that can be made on the chess-board is so great that probably no two games exactly alike were ever played; so no two games which the student plays with nature to wrest from her her hidden truths, which were worth playing at all, ever made use of quite the same methods in quite the same way.

But in some branches of economic inquiry and for some purposes, it is more urgent to ascertain new facts, than to trouble ourselves with the mutual relations and explanations of those which we already have. While in other branches there is still so much uncertainty as to whether those causes of any event which lie on the surface and suggest themselves at first are both *true* causes of it and the *only* causes of it, that it is even more urgently needed to scrutinize our reasoning about facts which we already know, than to seek for more facts.

For this and other reasons, there always has been and there probably always will be a need for the existence side by side of workers with different aptitudes and different aims, some of whom give their chief attention to the ascertainment of facts, while others give their chief attention to scientific analysis; that is taking to pieces complex facts, and studying the relations of the several parts to one another and to cognate facts. It is to be hoped that these two schools will always exist; each doing its own work thoroughly, and each making use of the work of the other. Thus best may we obtain sound generalizations as to the past and trustworthy guidance from it for the future.

* * * *

The laws of economics are to be compared with the laws of the tides, rather than with the simple and exact law of gravitation. For the actions of men are so various and uncertain, that the best statement of tendencies, which we can make in a science of human conduct, must needs be inexact and faulty. This might be urged as a reason against making any statements at all on the subject; but that would be almost to abandon life. Life is human conduct, and the thoughts and emotions that grow up around it. By the fundamental impulses of our nature we all—high and low, learned and unlearned—are in our several degrees constantly striving to understand the courses of human action, and to shape them for our purposes, whether selfish

Adam Smith and Ricardo and their American disciples, seemed a wonderful dogma, fit to rank with Galileo's telescope and Isaac Newton's apple. It was so simple that it could all be written in a few pages. It told the poor exactly why they were so. Work, industry, liberty, free competition and a police force were all that was needed for social welfare. Every man got what he was worth and was worth what he got, and the world went of itself.

With the modernization of our education which began about fifty years ago, economics came sweeping in as a college subject. Students cried for it. Benefactors died for it. It reached and swelled till it filled a B. A. curriculum, turned into a graduate study and after that you could go to Germany and get more of it, and keep on with it until you died.

But even then, though no one realized it, the bottom was out of it. Political economy had taken too much for granted. Property, and above all property in land. Where did that come from, asked Henry George. And inheritance. Loosen the dead hand and let us see what it holds in its fingers. What? Is that fair! All that vast wealth. And labor, asked Karl Marx, does it get all it produces? If so, why hire it? And competition, asked a thousand complaining voices, as the complexity of our machine industry grew, why is competition fair, if the strong can crush the weak and vested interest take its toll of necessity?

Even the theory of the matter turned upside down like a capsized boat. Does cost of production really govern the value of a thing, or does the value of a thing dictate its cost? And with that the theorists were off to a new start, perplexed as Milton's arguing devils, who "found no end in wondering mazes lost." Thus did the experts wrangle and jangle in their own Paradise Lost. With the new century, economics, with the bottom knocked out of it, was carried forward floating on the mud, like Stephenson's first railway.

As a result, economic science has got itself into the tangle in which it is tied today. Of all the "economic truths" of a hundred years ago, I do not know of one—literally, not of one—that would pass unchallenged. Lord Bacon tells us that Pontius Pilate asked in jest, "What is truth?" and "would not stay for an answer." If he asked the question of the economists of today and waited for an answer, he would have to arrange his board for a long time in advance.

Nothing stands. John Stuart Mill was convinced that "productive labor" was the basis of social welfare—that and nothing else. Labor spent on producing mere luxuries was wasted. The spendthrift was an enemy to society. What he did was to "call for velvet clothes and champagne." Mill was a simple man, and a velvet suit and a bottle

of champagne seemed to him the last word for a wild time. We could show him something now. But the idea was that Mill's spendthrift, by calling for workmen to make him his suit and fix his drink, diverted them from producing real things that do not pass away—such as bridges, machines and factories. "A demand for commodities," said Mill, "is not a demand for labor." This he made one of his "four fundamental propositions" that held up the whole structure like the pillars of the medieval firmament.

But where is the argument today? Smashed to fragments. The loudest of our complaints are the voices calling for more spending of money. Anything to start it going. Prime the pump. Pension the old men. Give everybody in Alberta $25 a month. Don't produce, spend: Cut production down, limit it. Let the hog die unborn and pay the farmer for the corn he doesn't raise, on the sole condition that he will spend the money and not save it.

There again, saving! That, with all the economists from Adam Smith to his latest imitator, was the prime force in progress. There the interest of the individual and of society focused to a single light. If everybody worked hard and saved money, then everybody would get rich, the future would be provided for, and rainy days be stalled off till every place would be as good as Nevada.

They never stopped to ask what happens if every one sells and nobody buys—if we save enough to build so many machines that there's nothing for them to do. What if we do provide for the future? It hasn't come yet. How are we to get along till it does? Hence all the wrangle and jangle over "technology," technological improvement and technological unemployment, the waste of abundance and the superfluity of productive power.

I am not proposing to unravel the tangle—only to indicate it coiled all over the ground on which we try to advance. In fact it begins to look as if a "rainy day" were one of the best things in nature, and the more sudden the shower the better. Come on, loosen up and spend something. Have a cigarette.

So it seems that the bottom is out of the saving theory. That particular pillar is undermined and falling over. You may for the moment help yourself by saving money, but you're a poor pup in the social sense if you do. Go and buy a velvet suit and order a quart of extra dry.

Saving money! And there again the moment you say "money," off goes another explosion and up into the air a whole new mass of charred fragments. Scarcely a sentence is left intact of the old monetary theory that seemed as solid as bedrock. There it lay, the basis of our economic life and international trade—the doctrine of sound

money. It seemed as if half the economic evils of the past had come about for lack of the knowledge and practice of it. Everybody read in his economic scriptures of the evil of the Continental Dollar, the madness of the French Assignat and of how the Greenback was fought, slain and redeemed, as the dragon was fought by St. George.

Where is all this theory now? Nothing left, after the war explosion that blew it up, nothing except fierce, hot blasts of contrary opinion rushing into the vacuum. Monetary theory, or at least monetary practice, denounces solid sound money, and calls for money at least as bad as and if possible worse than that of other nations. "If you devalue your pound, remember we'll devalue our dollar. You can't work that stuff on us!" To cling to sound money would be to become a Christian all alone in the arena.

Of all these doctrines I am not attacking one. Of all these problems I am not solving any. I am only drawing attention to the hopeless muddle in which economic thought and practice has involved itself. It has become a mass of contradiction. Every nation is calling in one breath for freer trade and economic nationalism, for a sound currency as debased as possible, for rigid economy with plenty of spending—in other words, calling out, "High!" "Low!" "Up!" "Down!" "Begin!" "Stop!"—till all is a mere babel of voices.

Perhaps the best index of what has happened to the science of economics is what has happened to the teaching of it in our colleges. The colleges have a system for meeting such difficulties.

When opinion gets confused—living opinion—the colleges can always fall back on the opinion of the dead. If living men can't think, let's have a catalogue of all that dead men ever thought, and the students can learn that. In fact, economics can be all dosed up with history, as doctors dose a patient with iron. And statistics. If we don't understand the industrial world, at least let us have the statistics. The continental area of the United States is 3,026,789 square miles and the number of spindles in Lowell, Mass., is 201,608 (or is it?). That's the stuff. Make a four-year course and give a degree in it—a D. F.

And with that, of course, goes the familiar therapeutics of putting in "qualifications," what is called the "relative" view—that a thing is partly so and partly isn't so. Any book of what is called "general economics," after indicating the continental area of the United States and the number of spindles in Lowell, Mass., proceeds to a series of propositions as to why wages partly rise and partly don't, why prices may fall, or perhaps heap up, proving that black is in a sense white, except that where it is white it is partly black. This course is called Economics 1. From it you get to first base.

And, most of all, if we can't understand it let's at least see that

outsiders don't. Let us dress economics up in esoteric language, give it a jargon of its own, and break away from plain terms like labor and profit and money and poverty. Let's talk of "categories" and "increments" and "margins" and "series." Let's call our appetite for breakfast our consumer's marginal demand. That will fool them. And if I buy one cigar but won't buy two, call that my submarginal saturation point for nicotine.

Above all, let us call in the help of the psychologist. He's the fellow with the technique. Turn him on to the theory of value and grandfather Adam Smith won't know his own offspring.

Accordingly, the theorist of today, following in the tracks of the dead scholasticism, the lost Babylonian and the Egyptian dozing in the dust of the pyramids, runs his economics to finer and finer distinctions that have lost all meaning for everyday life. He can no longer talk of our wants; he must have marginal wants, degrees of wants, increments of satisfaction, curves of desire meeting in an equilibrium. The difference as between plain language and this jargon is as between digestion and a stomach ache. To the college economist a boy standing in front of a pastry shop represents a submarginal increment of satisfaction. Give him ten cents and he comes out with a consumer's surplus in him. You can see it sticking out.

If anyone thinks this argument overdone, this language strained, let him open with me the latest of the books on pure economic theory, the books that have such titles as the Theory of Value, of Capital, of Investment, anything like that. It would be invidious to name them singly since this is an attack not on a man but on a method.

Here before me on my desk is one of the latest, a book that will be pronounced by the reviewers as one of the really "big" things—an "outstanding contribution," that's the phrase. The ordinary person can no more read it than he can read Chinese. Here is a sample of how this outstanding contribution stands out:

> The slope of the curve passing through any point P has indeed a very definite and important meaning. It is the amount of Y which is needed by the individual in order to compensate him for the loss of a small unit of X. Now the gain in utility got by gaining such an amount of Y equals amount of Y gained times the marginal utility of Y; the loss in utility got from losing the corresponding amount of X equals amount of X lost times marginal utility of X (so long as the quantities are small). Therefore, since the gain equals the loss, the slope of the curve
>
> $$= \frac{\text{am't of Y gained}}{\text{am't of X lost}} = \frac{\text{marg'l utility of X}}{\text{marg'l utility of Y}}.$$

The author naively adds: "Have we any further information about the shapes of the curves?" No, I hope not.

I was once the guest of that merry institution, the Savage Club of London. Among the mock stunts of the evening was a speech supposedly in Chinese with an interpreter to explain it. After the bogus Chinese guest had spoken about a half a dozen sentences, the chairman politely interrupted, and asked of the interpreter, "Now, what has Mr. Woo-hoo said?" "Nothing, so far," said the interpreter.

The same is true of the quotation. It only means that when you have enough, you don't want any more.

A thousand chapters have been written similar to that sample. Take enough of that mystification and muddle, combine it with the continental area of the United States, buttress it up on the side with the history of dead opinion and dress it, as the chefs say, with sliced history and green geography, and out of it you can make a doctor's degree in economics. I have one myself.

3

PROBLEMS OF ECONOMIC TERMINOLOGY

ASHER ISAACS

LANGUAGE SERVES the purpose of communicating thoughts. The more exact the language and the clearer the terms used, the better the understanding. The word *definition* itself suggests the setting of clear limits to the meaning of a particular word. Scientific terminology is a good example of definite meaning. But in communicating thoughts, it is found frequently to be of use to draw on the *familiar* and to lead to a better understanding of the new or less familiar. Thus it is helpful for the scientist to tell the layman that the human stomach is like an

apple in size. Such a comparison would be of little or no use in a region where none had seen an apple; but where the apple is familiar, the size of the stomach, although unseen by the layman, becomes understandable. Thus far, the device of the simile is helpful, but it can become misleading and possibly harmful if the simile be carried farther and the human stomach is given all of the characteristics of an apple.

This danger surrounds us especially since public economic policy and government action frequently rest upon such reasoning. Pump priming is a perfectly good use of the principles of physics, but pump priming where dollars are used might be disastrous economics. A new deal might be perfectly clear to four card players intent on killing off an evening, but when a New Deal in economic life of necessity calls for marked cards—capital, labor, agriculture, etc.—the results are serious.

All sorts of imagery, then,—the simile, the metaphor, the analogy, the symbol, the allegory, the parable—have their places in communicating thoughts, provided their implications and connotations are kept strictly apart. Take imagery away from the poet and from the prophet, and you have little left. To some degree, it would be the same as commissioning an artist to paint a sunset, but denying him the use of his colors. A sunset in black and white might be novel but hardly informative.

Alfred Marshall, the celebrated British economist, comments that:

> It has been well said that analogies may help one into the saddle but are encumbrances on a long journey. It is well to know when to introduce them; it is even better to know when to stop them off. Two things may resemble one another in their initial stages; and a comparison of the two may then be helpful: but after a while they diverge; and then the comparison begins to confuse and warp the judgment.

The application of imagery, especially analogy, to scientific communication holds, of course, more danger to clear thinking than when applied to everyday literature or used in everyday conversation. For this reason, we seek more and more refinement in definitions of scientific terms and in descriptive language. The problem of the scientist is easier than that of the social scientist. The problem, again, is simpler where a *new term* is coined to cover a situation. Such a term has no other meaning to live down or slough off; it raises no other pictures from unrelated fields.

The vocabulary of economics and the social sciences was established *before* the social sciences assumed their identities. In addition, the

subject of economics, and to a greater or lesser degree, the other social sciences, has suffered from the lack of new terminology just as it has felt the lack of laboratory methods for experimentation. In fact, a partial explanation of the use of the analogy is the result of this very situation. (We shall see more of the relationship of definition, analogy, and the methods of the social sciences as we go further in this analysis.) Perhaps political science has escaped some of the problems in that this field has benefited somewhat (and perhaps, suffered) from the more exact terms of the legal field.

In economics there has been no Latin or other foreign language to hide behind because much of the basic work has been done by English-speaking persons. There have been no esoteric symbols with which to work. Even the so-called mathematical school of economics has made its appearance late and has by no means taken over any great segment of the subject or economists. The mathematician can lose the average layman just beyond arithmetic, and the survivors disappear progressively with algebra, plane and solid geometry, calculus, etc.

But as soon as economics is defined as a study of want-satisfaction or business activities, or the art of making a living, it tends to make each business man into an economist. Or if it is defined as the science of money, it makes everyone an economist of sorts. The result is almost as bad as defining medicine as a study of illness and then assuming that every sick person becomes *ipso facto* something of an authority in medicine. The doctors, however, have been able to shove aside the layman with some degree of contempt and write illegible prescriptions or use language and symbols which frighten all except the bravest layman.

Economists have taken the terms of everyday conversation and have tried to give them a narrower or more precise meaning. But this process has meant the unsuccessful attempt to get rid of connotations or barnacles which have attached themselves through usage. Thus a key term such as *wealth* awakens many reactions in a person's mind—religious, critical, radical, defensive, offensive connotations. Similarly the terms *capitalist, landlord, rent, supply and demand,* have meanings far beyond the economist's concepts. Of course all of us are not as naive as the western bank bandits who demanded $40,000 from the teller and ignored additional sums within their reach. When caught and questioned by F. B. I. agents as to why they asked for just $40,000, they answered that they saw that figure printed as the bank's *surplus* and felt that the bank did not need it. Yet has not our national program treated *corporate surplus* and *excess profits* in something of the same spirit?

The economist has not been very successful in getting rid of the connotations—perhaps less successful than the specialists in other fields. The doctor, seemingly, can refer to opium and limit his reference as a drug used in medicine, even though the word flashes to the layman, habit-forming drug, pain-killer, opium-smoking dens, the Far East, mystery, and what not.

Economics has suffered from the curious difficulty of resistance of economists to new terms. We recall a remark in class by Professor Frank William Taussig, whose name was associated with Harvard for half a century, that he had never succeeded in introducing a single term and winning general acceptance for it. Economists have no international group on nomenclature as do the chemists, or a United States Pharmacopoeia or National Formulary as do the doctors and pharmacists; no courts and judges to define terms. Thus, while pure gold means only one thing to every chemist in the world, a gold standard in economics means a dozen things under various circumstances.

The terms of economics—insofar as they have some semblance of restricted meanings—are the contributions for the most part of one man, Alfred Marshall of Cambridge University, whose rich life covered 82 years until his death in 1924. Among his terms generally accepted today are *quasi-rent, consumer's surplus, producer's surplus, representative firm, opportunity costs, equilibrium, symmetallism, supply and demand schedules and curves.*

Our terms have been influenced by the use of analogy, which, in turn, is the outgrowth of our lack of the laboratory method of experimentation. We have used the recognized methods of induction and deduction and then found ourselves in a controversy with some German economists as to which we used more. And the analogy used by Alfred Marshall to answer the Germans serves itself to show the danger of analogy. He counters with the question: Which blade of the scissors does the most cutting? or which foot does the most walking? But obviously, the conclusion that induction and deduction are used simultaneously and equally is not necessarily true.

Our analogies (and therefore many of our terms in economics and business) come from nature and the two sciences closely associated with nature, physics in its broadest sense and biology in its broadest sense. One writer calls John Locke the Galileo of Economics and Adam Smith the Sir Isaac Newton of this subject. Moreover, Sir William Petty, an early economist, was a friend of Sir Isaac and was also a distinguished physician. Another founder of economics was likewise a medical practitioner and court physician. François Quesney. It is not at all surprising that some physical and biological analogies and terms

found their way into economics through these men and others of similar training. Some of this was accidental, but some was the result of a hope to reduce human behavior by such analysis to its simplest elements—to build laws of human motion somewhat akin to mechanical physics.

Let us list some of the current economic and business terms which clearly are related to the field of physics: inflation, deflation, flow of wealth, floating a loan, sinking fund, watered stock, liquid assets, frozen assets, elasticity of demand, inelasticity, cycle and the general notion that that which goes up must come down, barometer, pendulum, balance, equilibrium, pump priming, horizontal, vertical, circular combination, engines, statics, and dynamics.

It is not at all difficult to see these uses. An economic system is flat; hence inflate it. Water is not coming through the pump; hence prime it. The public is not spending money; let the Government start the flow. Assets are liquid until they become frozen. Hence seek a Reconstruction Finance Corporation to thaw them out.

The wide field of biology has been drawn upon heavily—seemingly because economics likewise deals with human beings. A great many examples come to mind. Each colony has a mother country. Hence the economic policies of the daughter colony must be filial, unselfish, modest, docile. Or to look at it from the mother country's viewpoint: the latter is to dictate, reach the proper decisions, control, protect, guide, and direct. The concept of growth and decay have given us the terms and analogies of infant industry in our tariff reasoning, growing business, old firm, representative firm, and on a national scale, geopolitics—a belief that a nation's insatiable mouth is located on its borders and that it must consume adjacent territory in order to live. Much of our economic reasoning is built upon the idea that a nation is like a person and what is good sense on the part of one is likewise good sense on the part of the other. The one discordant voice in this respect was that of the German economist, Friedrich List, who insisted that a tailor is no nation and a nation no tailor; one family is something very different from a large national territory.

What sap is to a tree has become for economics the profit of the economic system in the reasoning of some writers. The branch of the tree became early a symbol of economics: "all branches of commerce are interdependent; and although one branch may seem prejudicial, nevertheless, to lop it off may kill another, which by secret fibres has relation to it." Similarly the branch of a business has become a concept in economics—but again with connotations which are of little help.

Early economists were impressed by Dr. Harvey's teachings regarding the circulation of the blood. Harvey spoke of "the arteries . . . getting ruptured through the excessive charge of blood" and demonstrated the effect of the obstruction of the blood stream in the arteries by ligature on the arm of a man. And we find that Adam Smith explains the evil of concentrating British trade into just the colonial channel with the American colonies rather than with many smaller markets in the same way. Writing in 1776, he declared that colonial trade

> resembles one of those unwholesome bodies in which some of the vital parts are overgrown, and which upon that account, are liable to many dangerous disorders scarce incident to those in which all the parts are more properly proportioned. A small stop in that great blood vessel, which has been artificially swelled beyond its natural dimensions, and through which an unnatural proportion of the industry and commerce of the country has been forced to circulate, is very likely to bring on the most disorders upon the whole body politic. The expectation of a rupture with the colonies, accordingly, has struck the people of Great Britain with more terror than they ever felt for a Spanish Armada, or a French invasion.

The reasoning about the circulation of the blood also became the basis for economic reasoning on the circulation of goods and money. The importance of money was also emphasized by other analogies. For one writer, money was the lymph; for another, the fat of the body politic, "whereof too much doth as often hinder its agility as too little makes it sick." Money was thought of as the sun; gold and silver were considered as having been intended by nature to serve as money. A speaker from Colorado sought in vain in 1896 to have bimetallism recognized in the Republican Platform by insisting, "When the Almighty created these twin metals, He intended that the world should use them for the purposes for which they were created." He decried man's attempt to separate these twins.

* * * *

The sterile nature of money also played an important part in the development of economic theory. The physiocrats, for example, suggested in effect that the farmer was productive but that the business man was not—the proof being that a bushel of wheat used as seed would multiply many fold by harvest time—whereas a bushel of gold pieces similarly planted would yield no increase. This same type of

reasoning contributed to the touchy problem of usury and interest. Still another biological connotation connected with gold and money is hoarding, a term suggesting the fall activities of squirrels, and highly desirable for squirrels but disruptive when followed by man.

Still another biological contribution to economic thinking is the concept of competition and the survival of the fittest. This, of course, will be recognized as one of the most important parts of economic theory and also of our federal legislation today represented by the Sherman Anti-Trust Act, the Clayton and Federal Trade Commission Acts, the Miller-Tydings Act, the Robinson-Patman Act, and so on. The origin of the biological view is of interest. Although Adam Smith had a pretty strong idea about human instincts—for example, a man is born with a propensity to truck, barter and exchange one thing for another—and although he favored freedom from restraint, he did not picture cut-throat competition and survival as the final goal. But in the writing of Joseph Townsend may be found the beginning of it. In his *Dissertation on the Poor Laws* in 1786, Townsend shows a terribly deep concern for, and impatience with, the manner in which government had subsidized poverty, seemingly keeping alive those who might otherwise succumb to lack of food. He felt that men were animals and would conform to this law of nature if left free from government interference. Townsend's ideas got into the economics of Malthus and into the thinking of Charles Darwin. Thus a more or less mild type of competition as pictured by Smith assumed the biological "survival of the fittest" tone.

In biology there is the concept that in the course of its ontogeny, each organism repeats the history of its ancestral development, or its phylogeny. In other words, the human embryo goes through the stages through which the human animal passed. We find a present-day economist arguing that mankind has a history which is the phylogeny of the human species. Hence because we know this, he insists we can provide guidance for the social evolution of the species to whatever goals we think desirable.

We often find the challenge to young economists to clothe the dry bones of economic theory with the flesh of facts. But obviously bones do not bear a theoretical relationship to the body and an economics built on a structure of theory would soon collapse.

Even the term *wealth,* a key term in economics, comes through the biological concept of a *well* person—wealth as the state of being well as opposed to an ill person. Yet, strangely enough, we have never taken on John Ruskin's antonym, *illth.*

The lack of a laboratory method in economics has already been pointed to as being in part responsible for the use of analogy. We have substituted a sort of make-believe. For example, economists sometimes resort to a Robinson Crusoe type of analysis. Modern economic society being too complex and too swift in its movements, the economist removes as many troublesome elements in the picture as possible by postulating a Robinson Crusoe on a deserted island where his actions can be watched unobserved. The adjustments he makes are taken to be natural, simple reactions. Certain theories of economic behavior are built up. Then to see if these theories apply to the more complex life—and with the hope that they will become principles in the process—the life of Crusoe is allowed to become more complex. The man Friday appears. This brings up private property, master-servant relationships, division of labor, payment, economic rights and privileges, increased productivity, etc. The dangers of this type of imaginary behavior becomes apparent. Robinson Crusoe does as little or as much as we are willing to read into him. It is the economist, not Robinson who is really acting. And the economist knows the end of the story before beginning it.

Nor is our predicament helped very much by the much more elaborate concepts borrowed from physics, namely statics and dynamics. It enters into much economic thinking but reaches its climax in two large books written by John Bates Clark, long associated with Columbia University. The first was written in 1899 and deals with economics in a static or stationary state. The second appeared in 1907 and dealt with economic dynamics. Clark's thinking may be expressed in his own words:

> The first fact which becomes apparent when economic progress is studied, is that static laws have a general application and are as efficient in a society which is undergoing rapid transformation as in one that is altogether changeless. Water in a tranquil pool is affected by static forces. Let a quantity of other water rush in and there are superinduced on these forces others which are highly dynamic. The original forces are as strongly operative as ever, and if the inflow were to stop, would again reduce the surface to a level. The laws of hydrostatics affect the waters in the rapids of Niagara as truly as they do those in a tranquil pool; but in the rapids a further set of forces is also operative.

Alfred Marshall also considered the stationary state. He regards it as a pound—the legal device for fencing in, as an enclosure confining

dogs, cattle, etc. The economist faced with a complicated problem is advised to erect a pound and shut up in it the undeniable yet disturbing elements which he is not ready to treat. "With each step of advance, more things can be made less abstract, realistic discussion can be made less inexact than was possible at an earlier stage."

Another danger in the use of analogy lies in its source. If that source is a specialized or limited one, misunderstanding can come from its generalization. This is probably what John Stuart Mill had in mind when he wrote the following:

> When maxims . . . collected from Englishmen come to be applied to Frenchmen, or when those collected from the present day are applied to past or future generations, they are apt to be very much at fault. . . . For every individual is surrounded by circumstances different from those of every other individual; every nation or generation of mankind from every other nation or generation; and none of these differences are without their influence in forming a different type of character.

These remarks are not intended as an argument for new terms in economics and the social sciences just for the sake of new terms or to mystify the laymen and the uninitiated. It is true that a new term with only the meaning given it by its inventor helps to clarify thinking. For example, the term *monopoly* meant originally one seller. Accordingly, anything this one seller did by virtue of having no competition came to be classed as monopoly. A lot of unpopular connotations were built around the term, too. After a while, the term was no longer applied to one seller but was given a wider meaning—such control over supply as to influence the determination of price. But this, in turn, did not cover certain situations. Hence in recent years, we find terms such as *monopsony* to describe a monopoly enjoyed by the buyer rather than the seller; *oligopoly,* to describe a few sellers who watch each other closely—automobile manufacturers, and so on.

Again, there is no quarrel with analogy as long as it is recognized as such and regarded as previously established knowledge that can be used in new settings. Perhaps our goal should be this: to stop trying to be like other sciences and be ourselves; to stop aping the exact sciences and develop our own techniques. Finally, it might be desirable to seek the common acceptance of as many definitions as possible and thus avoid wasted efforts in controversies which are created by differences of definitions rather than in basic thought. The economist, however, must not shut himself in a vacuum of void and

nonrealistic assumptions, but of necessity approach his task with an open mind, borrowing from others with care and constantly integrating his results so that human welfare may be benefited as a result of his studies.

4

THE NATURE OF CULTURE

RUSSELL A. DIXON and E. KINGMAN EBERHART

CULTURE IS A COMPLEX AND DYNAMIC CONCEPT which can be studied from many viewpoints. It includes the sum total of human relationships existing at a given time in a given place. It refers to the organized life of a group functioning under the conditions of a given environment. From another point of view a culture is a distinctive organization of society in which the various integral parts form a meaningful and homogeneous pattern.

A. THE CONCEPT

Perhaps the nature of culture can best be understood by studying its distinguishing characteristics. In the first place it is distinctively and exclusively human. The three great achievements of man which have enabled him to develop an elaborate culture are language, writing, and printing. Until he had acquired the physiological attributes of speech and a mind capable of profiting from experience he was not truly human and did not have a cultural organization. Until writing was invented culture was passed on from one generation to the next through the oral tradition. Writing so greatly increased man's powers to accumulate tradition and knowledge that, until recently, history

was supposed to have begun with this significant invention. Printing has been the last great step in speeding up the process of preserving the knowledge of past generations and making it available to the current one. The second characteristic of culture is that it involves an integrated group. A culture is something more than the sum of its parts. The pattern which the parts produce is a distinctive aspect of it. Thirdly, culture is largely psychological; that is, its pattern is not so much a result of the integration of material items as it is a result of the beliefs, attitudes, and traditions (called the ideology) of its members. Fourthly, it is supra-individual in the sense that while each individual is a culture carrier, the culture itself is not dependent upon any given individual. Culture, like population, continues even though none of its original individual bearers are living after the lapse of a hundred years. Fifthly, culture is non-biological. Not a single item of culture is carried in the germ cells of any individual. The physical structure of the most primitive peoples is not observably different from that of the citizens of the most highly developed civilization. Even the purely physical and natural environment is often identical. The natural resources were all present in western Pennsylvania when the Indians were there but no coal or iron industry existed. Finally, culture develops, changes, and spreads by the two fundamentally human processes of invention and diffusion. . . .

There are two *basic elements* in every culture: man and nature. Man must live in some kind of natural setting. In early times it was a harsh and unmodified physical environment to which man adapted his mode of life. In recent decades man has modified the natural setting so greatly in certain urban regions that the original contours of the land are no longer recognizable. Out of the basic elements of man and nature there has risen during the centuries one culture after another, each having its own distinctive pattern of physical, social, intellectual, and religious elements.

The cultural pattern, however, is more than the aggregate of these and other aspects. All must be inter-related in such a way that they form an integrated and unified whole. All parts must be consistent with the general pattern. They must fit together to make a complete pattern in the same way that the pieces of a jig-saw puzzle must all fit together to make a unified picture. A box containing an assortment of odd and queerly shaped pieces of wood does not constitute a jig-saw puzzle, unless the pieces can be assembled into a meaningful whole. Every piece must have a distinct place and must contribute to the ultimate design. If we take ten pieces from each of five puzzles which contain fifty pieces each, we shall have the correct number of parts,

but they will not constitute a new picture puzzle. The pieces cannot be assembled into a new design because they are not homogeneous. They do not bear any consistent relationship to each other, and they cannot be assembled into any intelligible pattern. It is much the same with a culture. A mere aggregation of elements (traits) assembled from various cultures could not possibly constitute a cultural pattern. They would not be compatible. The various aspects of a culture must be consistent with one another and they must be organized into a functioning entity.

B. ASPECTS

From a structural and functional viewpoint culture consists of two parts: the social milieu and the social process.

1. *The Social Milieu* is the sum of the factors which condition man's behavior; it is the totality of the forces which impinge upon an individual or a group and in terms of which behavior becomes meaningful. The nearest English word which is roughly equivalent to the French term "milieu" is "environment." It is not a very satisfactory synonym because it seems to have acquired the connotation of physical things like geography, topography, and climate. The milieu, however, includes intangible as well as physical things. In fact, the milieu itself is made up of two distinct but interrelated parts: the physical environment and the social environment.

a. *The Physical Environment* consists of all the nonhuman aspects of culture. All the materials and forces of nature and all the material products of man's economic activity are its elements. Climate, topography, and natural resources are the chief items in the physical world. Of course natural resources include not only the inanimate things such as minerals, water, and land but all the animate items except man. Plants and animals are all included in this broad category. But the physical environment also includes the material products of man's activity. Buildings, streets, pipe lines, machines, and other items, which are merely modified forms and combinations of naturally existing elements, are the products of man's activity and depend for their maintenance upon him. These and all other material products of human effort are a part of the physical environment. These obvious and tangible parts of the social milieu are not the most important elements of a culture, however.

b. *The Social Environment* is the part of the social milieu which gives a culture its distinct characteristics. It is composed of man in his complex and varied relationships. It consists in part of actual persons but not as a mere aggregation of men. The

social environment finds expression in special-interest groups, institutions, social controls, science, technology, attitudes, the social heritage and many other aspects of a society. The social environment consists of all the more ethereal, psychological, and evasive forces of a culture which find expression in and give meaning to the physical aspects. The whole milieu, physical and social, constitutes the matrix in which a given culture operates.

2. *The Social Process:* The actual operation of a culture; that is, the actual functioning of the cultural pattern in the everyday lives of people, is a dynamic thing. It is the *social process.* It involves actions and reactions—behavior. We might define it simply by saying that the reaction of individuals and groups to their social milieu is the social process. All human activities are part of the social process, but from the economic point of view its most important forms are occupations, social controls, and the making and diffusion of technological changes. The social process is culture undergoing application and change.

5 ·

SOURCES OF ECONOMIC DEVELOPMENT

HAROLD G. MOULTON

THE PRIMARY SOURCES of economic growth and development may best be revealed by a study of the factors involved in the great economic expansion of modern times. The hundred-year period preceding 1930 was one of wholly unprecedented economic growth. If recorded history were reflected on the face of a clock, the period up to 1830 would represent the time from 12:00 midnight to approximately 11:40 in the morning, while the remaining 20 minutes until noon

would represent the century from 1830 to 1930. The astounding fact is that during this 20 minutes economic progress—as measured in terms of the increase in output per man per hour—was as great as that in the entire 700 minutes of preceding time. What were the sources of this phenomenal development?

Before undertaking to appraise the forces responsible for this extraordinary economic growth, it will be interesting to note how the economic analysts of the preceding century foresaw the future. Beginning with Adam Smith, who published his *Wealth of Nations* in 1776, a succession of economic writers known as the classical school had formulated by the middle of the nineteenth century a systematic body of economic principles which set forth what they regarded as the controlling factors in economic development. The ultimate expression of this general system of economic thought is found in John Stuart Mill's *Principles of Political Economy,* published in 1848. These scholars, like their colleagues in the natural sciences, based their conclusions on fundamental physical factors which they believed to be of decisive importance.

I. THE DISMAL FORECAST A CENTURY AGO

The extraordinary economic expansion which was to occur was not expected by the classical school of economists. On the contrary, most of them forecast a relatively static situation in which there appeared to be little hope for improvement in the lot of the masses. Let us review briefly the arguments on which this somber outlook rested.

The first physical fact which the early economists emphasized was the "niggardliness of nature." Land and other natural resources were none too productive at best; and the supply of the richer areas was very limited. *Scarcity* of resources was thus regarded as an inescapable limiting factor.

Coupled with the scarcity of resources was the law of *diminishing returns.* It was recognized that the yield of land might be materially increased through improved methods of tillage and more intensive cultivation; but it seemed obvious that there were very definite limits to the productive power of any given acre of ground. Moreover, it was noted that the point would soon be reached where the added yield would not be proportional to the added labor and other costs; that is, the *returns* would *diminish* in relation to the effort expended. Accordingly, as population increased, there could in due course be no escape from decreasing output per man hour. It would be necessary either to cultivate the more fertile areas under conditions of diminishing returns or to bring under cultivation poorer and still poorer land.

It was conceded that new highly productive agricultural areas might still be discovered or opened to settlement; but such possibilities were limited. It should be remembered that even at this time much of the great Middle West of America had already been penetrated by pioneer settlers, and that it did not appear probable that other virgin areas of comparable significance existed on the planet.

Thus the scarcity of rich land and the operation of the law of diminishing returns appeared to set definite limits to economic expansion. The same factors were regarded as equally operative with other natural resources—mineral, forest, and aquatic.

The second physical fact was the natural tendency for population to increase at a *geometric* rate. With productive resources increasing but slowly and subject to diminishing returns, there would inevitably be a continuous pressure of expanding population against limited productive resources.

Thus was laid the foundation for the *iron law of wages,* which held that actual living standards will always tend to be pressed down to the minimum of subsistence. While wars and pestilences might serve at times to reduce the excess population, there appeared little hope for any permanent improvement in living standards. The conditions of life in China, India, and other old civilizations afforded striking illustration of the permanent tendency of population growth to outrun the supply of productive natural resources.

In analyzing the factors responsible for economic progress, the classical writers placed comparatively little emphasis upon the potential significance of capital. Such epoch-making inventions as the steam engine and the steamboat, the cotton gin and the spinning jenny, were of course extolled as having made possible the factory system in manufacturing enterprise; and there was frequent reference to general "improvements in the productive arts." The importance of thrift was also emphasized. Indeed, it was pointed out that savings and the creation of capital were indispensable to economic progress. But it nevertheless remains true that these writers attached no *decisive* importance to machinery and other capital instruments as means of increasing productive efficiency and raising living standards.

Since Smith wrote before the industrial age, it was natural that he should attach little importance to capital instruments. Capital meant to him chiefly *stocks* of goods (inventories, in modern parlance), the materials which hand labor was engaged in processing. While Smith recognized that machines saved labor, they were discussed as a minor topic under *division of labor.*

The classical writers in general, while emphasizing the importance

of the principle of division of labor, did not of course deem it capable of continuous extension. It could not offset for long the operation of diminishing returns resulting from the pressure of population against limited natural resources.

The advantages derived from *geographic specialization* were regarded as of great significance. Since geographic regions were highly diverse in character, much was to be gained from concentrating production in each area upon the things for which it was best adapted and exchanging products with other areas. This conception was the basis of Adam Smith's argument that the most effective means of promoting the wealth of each and every nation was to abandon the restrictive "mercantilist" philosophy and remove all barriers to free international exchange.

John Stuart Mill, writing in the middle of the nineteenth century, had of course witnessed the first stage of the industrial revolution. Yet he saw no great potentialities in capital instruments. Rather he concluded that: "It is questionable if all the mechanical inventions yet made have lightened the day's toil of any human being." He was apparently impressed with the fact that the factory system had not as yet shortened appreciably the length of the working day or raised materially the level of real wages—which was constantly depressed by the rapid increase in urban population.

Two lines of reasoning contributed to this pessimistic conclusion. On the one hand, it was noted that the amount of money set aside for capital investment depends upon the ability and also the disposition of the people to save. Saving of course involves sacrifices—a restriction of present consumption. But for a double reason the great majority of human beings could not be expected to save much. First, they were, in the main, regarded as shiftless and thriftless—almost wholly lacking in forethought; and, second, the existing plane of living was so meager that there was little if any margin out of which savings might be made. Hence large savings did not appear probable—however much the virtues of thrift might be extolled.

A second line of reasoning proceeded from the demand side. It was observed that the rate of interest that would be paid for saving funds depends upon the efficiency of the additional capital goods that might be created. It was pointed out that since additional capital goods must be used in conjunction with limited natural resources, subject to the law of diminishing returns, the output made possible by additional units of capital would in due course decrease; and hence the rate of interest that would be paid for its use would naturally

decline. In consequence, the inducement to save would be lessened, and the flow of savings would be automatically reduced.

Thus even if the people should perchance for a time become more thrifty and be able and willing to increase their savings, the process would quickly become self-defeating.

Mill held that the rate of return on capital in a country of large production and substantial savings "is habitually within, as it were, a hand's breadth of the minimum, and the country therefore on the very verge of the stationary state." He noted, however, three factors which work to prevent interest and profits from reaching absolute zero. One was "the waste of capital in periods of over-trading and rash speculation, and in the commercial revulsions by which such times are always followed." Another was "the perpetual overflow of capital into colonies or foreign countries." A third was resulting "improvements in production" which by reducing costs extend the "field of employment." It will be observed that the virtue of the first two of these factors was found in the fact that they destroy or get rid of excess capital—thereby relieving the pressure. The emphasis placed upon these capital-destroying factors indicates that the third or constructive factor was regarded as of very minor importance. At the most it was thought of as providing additional employment. It was not conceived as a creative force capable of easing the burden of toil and progressively raising the levels of living for all mankind.

It is true that not all of the early English economic writers expressed equal pessimism about the future. Adam Smith was preoccupied with the immediate gains that might be obtained by removing hampering restrictions on enterprise and on trade, and he was not much concerned with the limiting long-run factors. Some writers attached more importance to the progress of the arts and to the perfectibility of human nature than did others. But it remains true that it was the somber conclusions, based on the limitations of nature and of man, which gave to political economy the appellation of "dismal science."

It should be added that there were a few early writers, outside the classical group, who were much more hopeful with respect to the future of economic trends. For example, an obscure Scottish writer, John Rae, foresaw unlimited possibilities flowing from "the progress of the inventive faculty"; and J. B. Say, a French economist with an industrial background, had a deep insight into the significance of mechanized industry. But they were looked upon as outsiders, and their studies were not even published in Great Britain.

It should be noted here also that as time passed economists in the classical tradition came gradually to attach great importance to industrial capital. Indeed, by the end of the nineteenth century, thrift, saving, investment, and capital accumulation were being extolled as the sources of progress and rising living standards. Even so, the specter of diminishing returns had not been allayed.

II. FACTORS OVERLOOKED

It is obvious that there was something basically defective in the analysis of the early classical economists—for instead of static conditions and perpetual poverty, we have had a highly dynamic society and an astounding improvement in the material well-being of all classes. Either their underlying assumptions were faulty, or important new factors which could not be foreseen entered the picture.

Two possible explanations immediately suggest themselves: (1) that the extent to which new agricultural resources might be discovered and opened for settlement had been greatly underestimated; and (2) that the influence of birth control in restraining the rate of population growth had been overlooked.

Some important agricultural areas were, to be sure, opened for settlement in the world after 1850; and the frontiers within the United States continued to be extended for another generation or so. But since the most rapid improvement in living standards has occurred since the disappearance of frontiers—that is, since about 1900—it is evident that the primary explanation is not to be found in the continued discovery of rich arable lands.

* * * *

Notwithstanding a decreasing birth rate in certain social groups, we have had an extraordinary growth in aggregate population. In fact, during this century the population of the world as a whole increased at a much more rapid rate than during preceding centuries. The British population rose from 26.7 millions in 1840 to over 47 millions a hundred years later; while that of the United States increased from 17 to nearly 130 millions. In this period, however, per-capita income, both in England and the United States, rose some three- to fourfold. In Japan from 1870 to 1930 the population more than doubled; meanwhile the standard of living, instead of falling as was expected, rose well over 100 per cent.

One of these developments—science and technology—was fundamental in character, operating directly to increase productive power and to offset the limitations of nature. The others were improvements

by science and technological applications. Among the most important of these were: (1) the creation of the corporate form of business organization; (2) the evolution of bank credit; and (3) the maintenance of improved monetary and fiscal systems. The significance of such developments could not of course have been perceived a century ago.

It will be observed that in this list of factors no reference is made to "free enterprise." This is because the so-called system of free business enterprise did not come into being *during* the period under review. It had already been in existence for a half century at least, and its virtues rather than being overlooked were vigorously expounded by most of the economic writers whose dour conclusions are summarized above.

A. Science and Technology

The most fundamental of the several developments which combined to transform the economic world during the last century has been the phenomenal advance in science. Without scientific discoveries and their application through engineering to the processes of production, the limiting factors discussed by the early economists might well have operated to prevent any great improvement in living standards.

The economists of a century ago had witnessed only the beginnings of the technological revolution. But most of the great scientific discoveries and inventions were yet to come. Engineering was still in the infancy stage, and the epoch-making developments in the fields of metallurgy, electricity, oil, and chemistry belonged to the future. . . .

In every field of production—agriculture, mining, manufacturing, transportation, public utilities—the developments which have occurred have increased manyfold the productive power of the individual worker. Instead of diminishing returns from natural resources—agriculture and mining—we have witnessed constantly increasing returns. This outcome is not so much a result of the discovery of *new* agricultural and mineral resources as of a more efficient use of *known* resources.

* * * *

B. Improvements in Economic Organization

Science and technology made possible vast increases in productive efficiency and provided the impetus for large-scale business enterprise. But the possibilities of large-scale enterprise could not be realized without certain accompanying developments in the realm of business organization. . . .

6 ·

A CRITICISM OF CLASSICAL THEORY

JOHN MAYNARD KEYNES

Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world. But if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own again from this point onwards. If we suppose the volume of output to be given, *i. e.*, to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportion the factors of production will be combined to produce it, and how the value of the final product will be distributed between them. Again, if we have dealt otherwise with the problem of thrift, there is no objection to be raised against the modern classical theory as to the degree of consilience between private and public advantage in conditions of perfect and imperfect competition respectively. Thus, apart from the necessity of central controls to bring about an adjustment between the propensity to consume and the inducement to invest, there is no more reason to socialise economic life than there was before.

To put the point concretely, I see no reason to suppose that the existing system seriously misemploys the factors of production which are in use. There are, of course, errors in foresight; but these would not be avoided by centralising decisions. When 9,000,000 men are employed out of 10,000,000 willing and able to work, there is no evidence that the labour of these 9,000,000 is misdirected. The complaint against

the present system is not that these 9,000,000 men ought to be employed on different tasks, but that tasks should be available for the remaining 1,000,000 men. It is in determining the volume, not the direction, of actual employment that the existing system has broken down.

* * * *

THE NATURE OF INSTITUTIONAL ECONOMICS

JOHN R. COMMONS

Going back over the economists from John Locke to the orthodox school of the present day, I found that they held two conflicting meanings of wealth, namely: that wealth was a *material* thing, and again that it was the *ownership* of that thing. But ownership, at least in its modern meaning of intangible property, means power to *restrict* abundance in order to maintain prices; while the material things arise from power to *increase* the abundance of things by efficiency in production, even in overproduction. Hence, ownership becomes the foundation of institutional economics, but material things are the foundations of the classical and hedonic economics, whose "corporeal" meaning of property was equivalent to the material thing owned.

Not until it became vaguely felt by the heterodox economists in the middle of the Nineteenth Century . . . that ownership and materials were not the same thing, were the beginnings laid for institutional economics. These economists were vague in that they had the older idea of "corporeal" property (even yet retained by economists), which identifies ownership with the materials owned, or distinguishes only "corporeal property" from the "incorporeal property" which is

contract, or debt. Hence, it was not until the new idea of "intangible property" arose out of the customs and actual terminology of business magnates in the last quarter of the Nineteenth Century that it was possible for Veblen and the Supreme Court to make the new distinctions which clearly separate from each other not only the ownership of materials and the ownership of debts, but also the ownership of expected opportunities to make a profit by withholding supply until the price is persuasively or coercively agreed upon. This ownership of expected opportunities is "intangible" property.

* * * *

Such an interpretation also consists in going back through the writings of economists from John Locke to the Twentieth Century, to discover wherein they have or have not introduced collective action. Collective action, as well as individual action, has always been there; but from Smith to the Twentieth Century it has been excluded or ignored, except as attacks on trade unions or as postscripts on ethics or public policy. The problem now is not to create a different kind of economics—"institutional" economics—divorced from preceding schools, but how to give to collective action, in all its varieties, its due place throughout economic theory.

In my judgment this collective control of individual transactions is the contribution of institutional economics to the whole of a rounded-out theory of Political Economy, which shall include and give a proper place to all the economic theories since John Locke, who first laid the theoretical foundations for the labor theories of value and for modern capitalism.

The first of the economists to make conflict of interests universal in economics was David Hume in his theory of *scarcity,* rather than Locke and Smith in their theory of divine *abundance.* But Hume, followed by Malthus, also made scarcity the basis of cooperation, fellow feeling, justice, and property: If there were unlimited abundance of everything there there would be no self-interest, no injustice, no property rights, no ethics.

It is only scarce things, actual or expected, that are wanted and desired. Since they are scarce, the acquisition of them is regulated by the collective action which creates the rights and duties of property and liberty without which there would be anarchy. Since this scarcity is a fact recognized by economists, they have already presupposed the institution of property in their very concepts of wants and desires. Institutional economics openly avows scarcity, instead of taking it for granted, and gives to collective action its proper place of deciding con-

flicts and maintaining order in a world of scarcity, private property, and the resulting conflicts.

I make conflict of interests predominant in transactions. But I conclude that this cannot be allowed to be the only principle, because there are also mutual dependence and the maintenance of order by collective action. I start, like economists, with scarcity, as universal for all economic theory. Then I proceed, as did Hume and Malthus, to show that out of scarcity derives not only conflict, but also the collective action that sets up order on account of mutual dependence.

Order, or what I call working rules of collective action, a special case of which is "due process of law," is itself quite changeable in the history of institutions; and I find this order concretely represented in the various rationing transactions, which would be needless in a world of abundance.

It is for this reason of scarcity that I make efficiency also a universal principle, because it overcomes scarcity by cooperation. But cooperation does not arise from a *presupposed* harmony of interests, as the older economists believed. It arises from the necessity of *creating a new harmony* of interests—or at least order, if harmony is impossible—out of the conflict of interests among the hoped-for cooperators. It is the negotiational psychology of persuasion, coercion, or duress. The greatest American piece of actual cooperation, latterly under ill repute, is the holding companies which suppress conflicts, if persuasion proves inadequate. . . . Hence, harmony is not a presupposition of economics—it is a consequence of collective action designed to maintain rules that shall govern the conflicts.

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8 ·

INSTITUTIONALISM

J. S. GAMBS

WITHOUT FURTHER ADO, let us begin at the beginning and try to find out what institutionalism is all about. Since there are many misconceptions of theory abroad, these early paragraphs will tell what institutionalism is not. First of all, it is no new and strange mystery completely unrelated to the doctrines of Adam Smith, Ricardo, Mill, and Marshall. Institutionalists accept much that standard economists believe; on the whole they seem to think that what standard theory has to offer is rather elementary and only the beginning of wisdom. Some institutionalists would probably say that their branch of economics bears the same relation to standard or orthodox theory that contemporary physics bears to Newtonian physics. Billiard balls still obey the old laws of motion despite Planck and Bohr, and mud flies off an automobile wheel in conformity with Sir Isaac's theories. But those round objects that click on green baize and seem so solid to the older physicists are, in fact, mostly empty space, and the particles of which they are composed rotate in myriads of galaxies. They do not lie inertly on the table (which is also composed mostly of nothing at all); their sub-microscopic particles pound down, while those of the table pound upwards, in what is actually a precarious equilibrium.

* * * *

The entire basis of economic theory is changed when coercion, or aggression, instead of competition, becomes the dominant theme of economics. Under the coercion principle the importance to an entrepreneur of properly disposing of scarce goods is minimized and the importance of creating or escaping a coercive situation is maximized. The institutionalist wonders whether the business man really spends

much time thinking about a dose of labor vs. a dose of capital. Does he not, in the modal case, apportion his resources approximately as his neighbor does, following community practice, rarely going beyond the information available to those who take but a superficial interest in the state of the industrial arts? Does he not, rather, think about such things as how he can maintain independence from his banker or from a larger firm, for which he subcontracts; how he can use patent or copyright laws to secure temporary or quasi-monopoly; how can Jones be appointed as head of the Housing Authority, since Jones is opposed to the building of houses, or Richard Roe to the Rural Power Commission, since Roe does not believe in electricity? The institutionalist would hold that a business man is less concerned with economic thoughts than with assessing the mood of the community as to where its sympathies lie in respect of a threatened strike; balancing the wisdom of fighting the Labor Relations Commission now against the advantages of waiting until after election; considering the desirability of doing a better job of public relations or the possibility of organizing a share-the-work movement during a period of unemployment in order to head off taxes and large appropriations for relief that would spoil the labor market. Leaders of labor and business and trade-association executives are constantly making non-economic decisions to achieve economic goals, according to institutional theory. These decisions possibly involve, so far as concern the profits or losses attributable to them, sums whose magnitude considerably exceeds the magnitude of gains and losses growing out of purely economic decisions. If such non-economic labors as those listed above are successful, scarce goods may be disposed of somewhat haphazardly, the institutionalist would say. If unsuccessful, an economic disposal of scarce goods may be of no avail.

Exchange, the institutionalists might argue, effectuates the trading of equivalents only when the powers behind the exchange are equivalent. The relations of supply and demand remain important, to be sure, not because they determine price, but because they strengthen or weaken one side in the conflict over price.

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Interesting corollaries flow from the doctrine of coercion. The first is a denial of the automatic organization of our economic system. In standard theory, as is well known, self-interest expresses itself in the sublimated form of fair competition between peers; this process has the ineluctable effect of employing all who want to work, guiding production, and supplying to each his needs according to his productivity. Standard theory has been revising this chain of hypotheses

during the past decade, but it has never been accepted at all by institutionalists or their precursors. Since men practice coercion rather than competition, since great and small power differentials make absence of economic conflicts between political equals the exception rather than the rule, the basic situation premised by standard theory does not exist, and the consequential organization of our economy is likewise a figment of the mind.

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The second corollary flowing from the basic concept of coercion is the role of money in economic life. Standard theorists hold that money is incidentally, to use Mill's language, a "unit of calculation" and essentially a "mere contrivance for facilitating exchange." To them the value of money is governed by the same laws that govern the value of ordinary commodities. The only difference, Mill says, is that thinking about money engenders confusion and illusion "in minds not scientifically instructed"; discussions of money are therefore often a "mass of vapoury and baseless speculation."

Institutional theory cannot deny that money provides us with a useful unit of calculation or that it facilitates buying and selling. But money is also much more than that. Possession of it is a goal of economic endeavor even after the demand for goods and services and reasonable security has been satisfied. It facilitates not only buying and selling but also buying cheap and selling dear. The very fact that discussions of money are often a "mass of vapoury and baseless speculation" makes possible obfuscations that may be made advantageous to some persons and disadvantageous to others. Since money is (with unimportant exceptions) the only credential required for consumption, no procedure exists whereby the market can distinguish between producers and nonproducers. There can therefore be no guarantee that productivity is rewarded. Man's behavior in respect of using and handling and "making" money is varied, irrational, complicated, and often confused—confused as dreams or primitive magic are full of confusion. This faltering and uncertain behavior is probably a contributing cause of the business cycle—a phenomenon confined to pecuniary economics.

In short, to the institutionalist, money is the nucleus around which cluster infinitely complex forms of human behavior. It is, indeed, a useful unit for reckoning and also the lubricant of sale and purchase; it is, besides, a weapon of attenuated economic coercion. In the monetary economy "fighting with the mailed fist is prohibited whereas fighting with pounds and pence is sanctioned."

The third corollary is the distinction made by institutionalists

between pecuniary and industrial employments. Obviously human beings cannot hope to enjoy long life if their economic activities are limited to general, mutual, and reciprocal coercion. A large part of human effort must go into production. Now, it may be that all persons, in getting their living, make use of their productive as well as their coercive gifts, but some persons and vocations are so completely developed in one or the other direction that a useful distinction can be made between aggressive economic endeavor and productive economic effort. Veblen's phrases are "pecuniary pursuits" and "industrial pursuits." The first is applicable to those who "make" money; the second to those who make goods or supply services of direct social benefit. Standard theory draws no such distinction, because the imputed integrating and organizing function of the moneymaker is considered to be, at least in its ultimate repercussions, a socially useful (productive) effort of high importance—exceptions always being made for such moneymakers as professional gamblers, *rastaquouerès,* and the like.

Institutionalism has already come to certain definite conclusions about psychology and economics. The first is that all economists use psychology, consciously or unconsciously, even when they are opposed to its use. This thesis has been competently defended. A second is that economic behavior is but a special form of behavior and therefore can be understood only if behavior in general is understood. Institutionalists therefore ask whether economics should not dwell with the biological sciences, instead of inhabiting some Shangri-la under the alleged governance of the physical sciences—which is where standard theory seems to have its being. If this question can be answered affirmatively a complete re-orientation of economic study is suggested. The unit of study now is protoplasm rather than prices; the subject is human behavior rather than the behavior of money or a unit of fertilizer or a dose of capital; the mathematics appropriate primarily to nineteenth-century physics are discarded in favor of the mathematics applicable to biology; rent is the income of a person, not the special contribution to production of a piece of land. Concepts relate to process, change, adjustment, rather than to equilibrium, statics, dynamics. To Veblen all this does not mean that economics becomes less nearly exact, or gives up the rigorous ideals of the more nearly exact sciences. Science is science, and if standards of workmanship fall below the highest, they should be improved. But the degree of exactitude possible at any given stage of development is dependent on the nature of the phenomena, not on the family connections claimed for any special science.

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9 ·

HOLISTIC ECONOMICS

ALLAN G. GRUCHY

In the first three decades of the current century the American movement to revamp economic science came to be known as "institutionalism," while the work of the economists concerned with this movement was described as "institutional economics." In the closing years of Veblen's career there appeared other American economists who were also greatly interested in the reconstruction of economics. Although their work has much in common with Veblen's economics, the younger exponents of economic heterodoxy do not describe their thought as "institutional economics." Such terms as "social," "experimental," and "collective" have been substituted for "institutional" in descriptions of the new economics. Since 1929, the year in which Veblen died, it has increasingly become the custom to use the term "institutional" to refer to Veblen's special accomplishments rather than to describe the efforts of post-Veblenian economists to carry on the work of reconstructing economics. It is not proposed [here] that any attempt should be made to alter the use of the term "institutional" which is now well established both in this country and abroad. . . . The suggestion is therefore made that some other term be adopted to describe the work of those American economists, including Veblen, who have been responsible . . . for the distinctive American contribution to modern economic thought. Since none of the descriptive terms used by the heterodox economists who came on the scene after Veblen has become widely used, the term "holistic" has been adopted in this study to describe the twentieth-century version of economics which has been developed by Veblen, Commons, Mitchell, J. M. Clark, and other exponents of economic heterodoxy. The term "holistic" has been selected because it calls attention to what is most characteristic of the

new economics: its interest in studying the economic system as an evolving, unified whole or synthesis, in the light of which the system's parts take on their full meaning.

The writer does not agree with those who believe that the new economics is a minor flank attack upon economic orthodoxy which will prove to be ephemeral; instead, it is his conviction that "holistic economics" is the product of a genuine reconstruction which will turn out to be of lasting significance. This twentieth-century version of economics reflects the many important changes which have occurred in the past half-century in both the material and intellectual foundations of American economic life. It came into being during that stage in the evolution of the American economy not only when this economy was undergoing many basic changes in both its structure and functioning, but also when new scientific and philosophical developments were playing havoc with inherited ways of thinking about human nature and the external world. As a product of the new age of mass production and monopolistic enterprise, the economics of Veblen, Commons, Mitchell, and other critics of economic orthodoxy stands in marked contrast to the equilibrium economics which originated in the era of small-scale, competitive capitalism. This contrast arises from the fact that the new economics introduces fundamental changes in philosophical orientation, methodological approach, and psychological interpretation. What is particularly important about the work of the holistic economists is that it represents one of the most thoroughgoing attempts to close the gap between economic theory and practice. The bridging of this gap is one of the most urgent problems now demanding attention from those who are deeply concerned with the future progress of the science of economics.

10

THE CONCEPT OF AN ECONOMIC EQUILIBRIUM

ARTHUR B. ADAMS

Suppose that the whole economic system is in a state of perfect equilibrium. To be in such a state does not mean that conditions are static. There may be many internal changes in an equilibrium, but each change is always neutralized by some other change in such a manner as to keep a balance within the system. In such an economic society goods would be produced, bought and sold, and consumed as in an unbalanced organization. Capital would be accumulated, methods of production improved, and much progress made without disturbing the equilibrium. It would be a moving equilibrium.

In such a society economic goods would be produced at a steady, slightly progressive rate. Cost of production and output of individual goods might be lowered or raised, and new kinds of goods might be offered in the markets. But goods as a whole would be produced at a constant rate. The rate of production would slightly exceed the rate of consumption of goods in order to allow for savings and the growth of capital.

The perfect economic equilibrium would allow for changes in prices in individual goods—the prices of certain goods might go up and the prices of others might go down—but under conditions of an equilibrium the general price level should not change. The purchasing power of the dollar would remain constant. This would mean that the total number of dollars of purchasing power available would have to vary in a direct ratio to the variation in the quantity of goods which were put on the market. As a steady gradual increase in production is assumed in the moving equilibrium, the same ratio of increase in the quantity of purchasing power is also assumed. In order to give stability to each unit of purchasing power, credit money (government

paper money, bank notes, and bank credit), if used, would have to be nonfluctuating so as not to disturb the stability of purchasing power of the dollar. All the money used is distributed among the various business enterprises and individuals, and they would use it primarily to keep goods circulating. Therefore, a constant velocity of circulation of money is assumed.

A fairly constant interchange of goods and money between business enterprises themselves, and between them and individuals, is assumed; and also that, on the whole, business enterprises keep about the same stock of goods (raw materials, semifinished, and finished goods) and money on hand from day to day. Also it is assumed that consumers, as a class, have about the same surplus amount of cash and goods constantly in store. The permanent capital equipment of business enterprises as a whole would not vary, except as it was slowly augmented by the accumulation of new capital.

The concept of an economic equilibrium does not necessarily presuppose stable wages, interest, rents, and profits. There might be some changes in the ratios between these factors without destroying the balance of the system. Certainly, this would be possible if the changes came about gradually, allowing for the adaptation of business enterprises and individuals to the changes. But rapid or violent changes in the distribution of the current money income are excluded as a possible disturbing factor.

11 ·

PHYSICAL NEEDS

WALTER C. LANGER

PERHAPS THE TYPE OF BEHAVIOR most common to man, as well as to all other animals, is finding and eating food. Nobody is exempt, for any appreciable length of time, from behavior of this kind. Personal observation teaches us that we take food, or at least have a strong tendency to do so, when we are "hungry" and that this tendency is absent when we are not "hungry." In other words, everyday experience indicates that this type of behavior is intimately related to some condition existing within the organism itself and that the tendency to behave in this way is, in large part, independent of environmental changes.

The environment, however, determines whether the particular behavior, the act of food-taking, is feasible at the moment or whether it must be preceded by other forms of behavior that make the food-taking possible. Let us examine your behavior under these circumstances. In order to avoid all unnecessary cultural complications let us suppose that you are camping far from the outposts of civilization. You have spent the afternoon swimming in the cool waters of a near-by lake and suddenly realize that you are hungry. Food-taking behavior would be extremely pleasurable, but since you brought no lunch, you cannot indulge in it at the moment. Other forms of behavior are called for before food-taking behavior is possible. In the present situation these forms consist of picking up your things and initiating walking movements that carry you to your camp where food is stored. You are dismayed, however, when you arrive there to discover that during your absence some animal has raided your larder, and there is no food left. Again the environment is such that food-taking is not feasible. Again other forms of behavior are demanded. You may sit

down and try to forget your hunger, but as time passes, its demands become more acute and persistent. The sensations are unpleasant and more difficult to tolerate. You can no longer sit still. You are impelled to do something to procure food and allow you to get it into your stomach.

A great many different ways of behaving in an emergency of this kind are at your disposal. You may pick up your tins and start hiking to the nearest house in order to purchase food from your neighbors. If the distance is great, however, this may not be a feasible way of meeting the situation. You may, then, pick up your gun and start out in search of game. You may hunt for bait and then take your fishing rod and go back to the lake and try your luck at catching fish. You may content yourself with picking berries in the neighboring hills. These are very diverse forms of behavior, but they all have a common goal, namely, to procure food.

We can learn a great deal from this simple example. *First,* an internal condition, which we ordinarily call *hunger,* is responsible for whatever behavior you initiate. If this condition were not present, you would not behave in this manner at this particular time. The demands made upon you are, therefore, independent of your external environment. The motivation comes from within yourself and not from outside. *Second,* the course of action you pursue will depend upon the nature of the environment in which you find yourself. If you are in a rich berry country, you will probably institute behavior appropriate to berry-picking. If you are not very far from a neighboring house, you will probably go there and buy food. If you are in country where game is plentiful but fish are few, you will probably take your gun and go hunting. In short, your behavior will be determined in large part by the possibilities your environment offers. You will choose the behavior that holds the greatest promise and involves the least amount of effort. *Third,* if the environment offers various possibilities that are about equally feasible, your choice will be determined by your own capacities or abilities as demonstrated in earlier experiences. If the hunting and the fishing are about equally good in this locality, and you are a good hunter, you will elect this alternative as a means of acquiring food. If you are a good fisherman but a poor hunter, you will elect the fishing alternative and so on. *Fourth,* your choice of behavior will also depend, in part, on your personal likes and dislikes. You may be a good fisherman, but not like to eat fish, in which case you would probably elect to try your hand at hunting, berry-picking, or hiking even though it would require less effort to catch a few fish. *Fifth.* when the first choice fails to produce the

desired results, you do not stop in your efforts. As long as the internal condition persists, you try one possibility after another and expend more energy in food-seeking behavior. Motivated by intense hunger, people frequently continue in their efforts to obtain food until they are completely exhausted. *Sixth,* there are a great many different objects which can, if taken into the stomach, satisfy your hunger even though some are preferable to others. You may have your heart set on a juicy venison steak, but if you fail to find a deer and bring him down, your demands become less exacting. You would then be content with a supper of wild turkey or squirrel or rabbit or whatever game you can find. If your attempts in this direction are unsuccessful, you are willing to consider fish even though you don't care for it. If these are unobtainable, you are quite happy to eat berries or anything else the environment can provide. In other words, we all have a list of food preferences. Those at the top of the list are most appetizing and tempting, but if they cannot be procured, we move down the list to less desirable substitutes. In extreme cases, such as those found among arctic explorers, men have been driven to slaughtering their dogs or chewing on their leather boots as a means of satisfying their hunger. We can add, *seventh,* that food-taking behavior ceases as soon as an adequate amount of food has been eaten.

There is little new in all this. Most of us are well acquainted with these facts although we did not frame them concisely. In our civilized society, however, these reactions are, under ordinary circumstances, fairly well camouflaged. In our culture we usually do not wait until we are hungry before we think of food. We have learned, in the course of time, to plan ahead. From constant repetition we know we are going to be hungry at fairly regular intervals and that the best way of meeting these future situations is to have a supply of food at hand and have it prepared on a schedule in order that our inner demands may not become excessive. We guard against an unpleasant emergency of this kind by performing work for pay which, then, enables us to buy food when the proper time arrives. Nevertheless, with all these precautions, situations do arise in the lives of all of us that are similar enough to the one used in our example for us to check our conclusions regarding man's behavior under conditions of hunger. In the large cities where hunting, fishing, and other primitive forms of obtaining food are not feasible, however, we are more accustomed to find hungry men asking for any kind of work in return for food, begging for money on the streets with which to buy food, or stealing it when other methods fail. We also know that there are people

in the large cities who are driven by their hunger to take scraps from garbage pails and eat foods hardly fit for human consumption. In times of war, also, people learn to eat and like many substitutes for the foods to which they are accustomed.

12 ·

MONEY-MAKING

ARISTOTLE

LET US NOW ENQUIRE into property generally, and into the art of money-making. . . . The first question is whether the art of money-making is the same with the art of managing a household or a part of it, or instrumental to it; and if the last, whether in the way that the art of making shuttles is instrumental to the art of weaving, or in the way that the casting of bronze is instrumental to the art of the statuary, for they are not instrumental in the same way, but the one provides tools and the other material; and by material I mean the substratum out of which any work is made; thus wool is the material of the weaver, bronze of the statuary. Now it is easy to see that the art of household management is not identical with the art of money-making, for the one uses the material which the other provides. And the art which uses household stores can be no other than the art of household management. There is, however, a doubt whether the art of money-making is a part of household management or a distinct art. They appear to be connected; for the money-maker has to consider whence money and property can be procured; but there are many sorts of property and wealth:—there is husbandry and the care and provision of food in general; are these parts of the money-making art or distinct

arts? Again, there are many sorts of food, and therefore there are many kinds of lives both of animals and men; they must all have food, and the differences in their food have made differences in their ways of life. For of beasts, some are gregarious, others are solitary; they live in the way which is best adapted to sustain them, accordingly as they are carnivorous or herbivorous or omnivorous: and their habits are determined for them by nature in such a manner that they may obtain with greater facility the food of their choice. But, as different individuals have different tastes, the same things are not naturally pleasant to all of them; and therefore the lives of carnivorous or herbivorous animals further differ among themselves. In the lives of men too there is a great difference. The laziest are the shepherds, who lead an idle life, and get their subsistence without trouble from tame animals; their flocks having to wander from place to place in search of pasture, they are compelled to follow them, cultivating a sort of living farm. Others support themselves by hunting, which is of different kinds. Some, for example, are pirates, others, who dwell near lakes or marshes or rivers or a sea in which there are fish, are fishermen, and others live by the pursuit of birds or wild beasts. The greater number obtain a living from the fruits of the soil. Such are the modes of subsistence which prevail among those whose industry is employed immediately upon the products of nature, and whose food is not acquired by exchange and retail trade—there is the shepherd, the husbandman, the pirate, the fisherman, the hunter. Some gain a comfortable maintenance out of two employments, eking out the deficiencies of one of them by another: thus the life of a shepherd may be combined with that of a brigand, the life of a farmer with that of a hunter. Other modes of life are similarly combined in any way which the needs of men may require. Property, in the sense of a bare livelihood, seems to be given by nature herself to all, both when they are first born, and when they are grown up. For some animals bring forth, together with their offspring, so much food as will last until they are able to supply themselves. . . . In like manner we may infer that, after the birth of animals, plants exist for their sake, and that the other animals exist for the sake of man, the tame for use and food, the wild, if not all, at least the greater part of them, for food, and for the provision of clothing and various instruments. Now if nature makes nothing incomplete, and nothing in vain, the inference must be that she has made all animals and plants for the sake of man. And so, in one point of view, the art of war is a natural art of acquisition, for it includes hunting, an art which we ought to practice against wild beasts, and against men who,

though intended by nature to be governed, will not submit; for war of such a kind is naturally just.

Of the art of acquisition then there is one kind which is natural and is a part of the management of the household. Either we must suppose the necessaries of life to exist previously, or the art of household management must provide a store of them for the common use of the family or state. They are the elements of true wealth; for the amount of property which is needed for a good life is not unlimited, although Solon in one of his poems says that,

"No bound to riches has been fixed for man."

But there is a boundary fixed, just as there is in the arts; for the instruments of any art are never unlimited, either in number or size, and wealth may be defined as a number of instruments to be used in a household or in a state.

* * * *

Of everything which we possess there are two uses: both belong to the thing as such, but not in the same manner, for one is the proper, and the other the improper or secondary use of it. For example, a shoe is used for wear, and is used for exchange; both are uses of the shoe. He who gives a shoe in exchange for money or food to him who wants one, does indeed use the shoe as a shoe, but this is not its proper or primary purpose, for a shoe is not made to be an object of barter. The same may be said of all possessions, for the art of exchange extends to all of them, and it arises at first in a natural manner from the circumstance that some have too little, others too much. Hence we may infer that retail trade [Ed. Trading for a profit?] is not a natural part of the art of money-making; had it been so, men would have ceased to exchange when they had enough. [Ed. Seemingly, Aristotle's grievance is that his contemporaries did not stop and did not know when to stop.]

* * * *

The most hated sort [of trade or money-making], and with the greatest reason, is usury, which makes a gain out of money itself, and not from the natural use of it. For money was intended to be used in exchange, but not to increase at interest. And this term usury, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of making money this is the most unnatural.

13 ·

PRIVATE PROPERTY

JOHN LOCKE

THE REASON WHY men enter into society is the preservation of their property; and the end while they choose and authorize a legislative is that there may be laws made, and rules set, as guards and fences to the properties of all society, to limit the power, and moderate the dominion of every part and member of the society. For since it can never be supposed to be the will of the society that the legislative should have a power to destroy that which everyone designs to secure by entering into society, and for which the people submitted themselves to legislators of their own making; whenever the legislators endeavour to take away and destroy the property of the people, or to reduce them to slavery under arbitrary power, they put themselves into a state of war with the people, who are thereupon absolved from any further obedience, and are left to the common refuge which God hath provided for all men against force and violence. Whensoever, therefore, the legislative shall transgress this fundamental rule of society, and either by ambition, fear, folly, or corruption, endeavour to grasp themselves, or put into the hands of any other, an absolute power over the lives, liberties, and estates of the people; by this breach of trust they forfeit the power the people had put into their hands for quite contrary ends, and it devolves to the people, who have a right to resume their original liberty, and by the establishment of a new legislative (such as they shall think fit), provide for their own safety and security, which is the end for which they are in society. What I have said here concerning the legislative in general holds true also concerning the supreme executor, who having a double trust put in him, both to have a part in the legislative and the supreme execution of the law, acts against both, when he goes about to set up his own arbitrary will as the law of society. . . .

14

LAISSEZ FAIRE—AFTER 100 YEARS

JUSTICE SIR JOHN BYLES

THE FOLLOWING ARE INSTANCES (among others) in which the State has, with general assent of the public, interfered with the liberty of individuals in respect to their separate action.

The State provides defences against external aggression.

It conducts treaties with foreign nations.

It preserves internal peace and order.

It is the corner-stone of family ties, family duties, family affection, family education, by regulating and enforcing the marriage contract.

It institutes and protects property.

It regulates the transmission of property.

It enforces the repair of highways by the several districts through which they pass, or by those who use them.

It obliges each county to make and repair its own bridges.

It maintains ports and harbours.

It surveys and lights the sea coasts of the realm.

It coins money, and prohibits interference with this monopoly.

It regulates the issue of promissory notes payable to bearer.

It provides a uniform system of weights and measures, and proscribes the use of any other.

It assumes the distribution of intelligence by post.

By the patent and copyright laws it gives bounties on the exertion of the inventive faculties, in the shape of a *monopoly* for a limited period.

By requiring a public specification, explanatory of every patented discovery or invention, it takes care that the secret shall not be hidden from the public or die with the inventor.

It imposes a bridle on the acquisition of property by corporate bodies.

It protects the public health by the prohibition of nuisances of thousands of kinds, and by making provision for their removal.

By the quarantine laws it prevents the importation of contagious diseases.

It provides for the cleanliness of towns.

It regulates the fares of hackney carriages and controls the drivers.

It forbids inoculation for the smallpox, and artificially promotes vaccination.

It assumes the distribution of insolvents' estates.

It provides for the maintenance of the poor.

It forbids perpetuities by avoiding all attempts to tie up property beyond a life or lives in being and twenty-one years afterwards.

Though it tolerates all religions, it does not leave the virtue and happiness of the multitude without the support and direction of an established faith and worship.

In the above cases Government interferes on behalf of *the public.* But there are others in which it does so to protect the helplessness or inexperience of individuals. Thus:

It shields infants by avoiding their contracts and protecting their persons and property;

And married women;

And persons of unsound mind;

And in many ways the helpless labouring poor.

It forbids the truck system.

It regulates the employment of women and children in mines and factories.

It controls pawnbrokers—grinding the tooth of usury, and securing facilities for redemption.

It prohibits and punishes, as we have seen, the use of unjust weights and measures;

And the sale of unwholesome provisions;

And the adulteration of coffee, tobacco, snuff, beer, tea, cocoa, chocolate, and pepper.

To guard against fraud, it directs the form and manner in which wills shall be executed.

If a man gives a money bond with a penalty if the money is not repaid at a day prefixed, the State forbids the penalty to be enforced.

A purchaser of gold or silver articles cannot tell whether they are real gold and silver or not, or how much of the weight is precious

metal, and how much is alloy. The State steps in to his assistance, and requires the assay mark of a public officer.

A man buys a pocket of hops. He cannot always open it to see whether it is of the growth alleged or of uniform quality. The State interferes and makes it penal to mark or pack falsely.

An attorney sends in his bill. The client cannot tell whether the charges are usual and fair. The State intervenes and provides a public officer who is empowered, not only to correct, but also to punish overcharges.

The State compels the professional education of medical men and attorneys.

The above are but some instances of the mode in which nearly all governments have found it for the advantage of the community to interpose.

What is the interposition of the Government?

Simply the concentrated action of the wisdom and power of the whole society on a given point; a mutual agreement by all, that certain things shall be done, or not done, for the general benefit.

15 ·

FOR THE BETTER ECONOMIC LIFE

C. H. GREENEWALT

Women were not freed from their 18th Century servitude by feminist agitation, but by the invention of the sewing machine, the washing machine, the refrigerator, and the dish washer, together with the revolutionary developments for handling and distributing foodstuffs.

Peasantry on the farm was not banished by reform or edict, but by the iron plow, the reaper, and the tractor.

The 12-hour shift and the six-day week could not have disappeared from the scene through laws or social upheaval. It was modern machinery, developed by research, that made it possible for the American workman of 1950 to produce many times as much goods as the workman of 1850.

The automobile, preeminently a product of research, has widened and enriched lives in a manner impossible to achieve through legislation. At every hand, it is plain that the improvements leading to advancement have their origin in invention and development. There is no alternative.

Ideas formed in a man's mind, after it has been trained and sharpened by education and experience, are the basis of successful research. Without the creative brain of the scientist, all investment in research is worthless. American scientific laboratories are the best equipped in the world. Yet continued progress will be insured only if the rights of the individual to exercise freely his initiative are reestablished and jealously guarded.

American research prospered by providing rewards for success; the inventive genius of the nation was kept alive by adding to it what Lincoln called "the fuel of incentive." Further, the integrity of American research was kept inviolate; the research worker was spared the necessity of finding "political" conclusions as the goal of his investigations.

In this atmosphere of free inquiry and of freedom of the individual to enjoy the fruits of his labor, science here flourished. Elsewhere in the world, it has suffered serious set-backs.

The German scientist, once a leader, found under Hitler that he was falling behind. Specified results at a specified time could not be guaranteed, no matter how urgent or peremptory the orders. The Russian scientist under communism has learned that his findings must satisfy the official view, regardless of the facts. The British scientist under socialism has seen the rewards of his enterprise virtually confiscated by taxation.

Without freedom, scientific research and the progress in its wake will falter in the United States, as has happened elsewhere. The individual must be assured the freedom of incentive. The university scientist must have freedom of inquiry, of discussion, and of publication.

And sponsors of industrial research, such as American companies, must have the freedom and incentive to win as well as to lose—the freedom to grow and expand, as is necessary to fulfill their responsibili-

ties. The means to carry on future research will be forthcoming only as long as it can pay its way.

When it can no longer do so, it will stop, and the retrogression process begin. In that event, a well-known principle would again be proved: a hoop rolling down hill moves faster than one going up.

16 ·

THE SPECIAL-PRIVILEGE NATURE OF MEDIEVAL TRADE

GEORGE BURTON HOTCHKISS

To UNDERSTAND THE ORGANIZATION, POLICIES, AND METHODS of the Merchants Adventurers—or of the Hanseatic League—it is necessary to bear in mind the fact that all trade during the Middle Ages, domestic as well as foreign, was a matter of special privilege. To-day we are so accustomed to thinking of the right to trade as a natural right that we forget how short is the period during which this idea has had any general acceptance. Throughout the Middle Ages and later, the privilege of selling goods had to be won by purchase or force, and was jealously guarded. This in spite of Magna Carta. As Gross says, "More than six centuries elapsed before the enactment of Magna Carta that all merchants 'may go through England by land and water to buy and sell free from all unjust imposts' became a realized fact throughout the realm."

The doctrine that the right to trade is the natural right of every free-born Englishman was not wholly unknown in Elizabeth's day. From time to time agitators argued in favor of opening certain kinds of trade (particularly the cloth trade in foreign markets) to all who wished to engage in them. A few of these agitators doubtless were

sincere; others were actuated by the selfish desire to get admitted to the favored group, after which they would gladly see the doors closed again. But whatever the motive inspiring the freedom-of-trade theory, it was regarded as an innovation. To Wheeler and his brother merchants it appeared a peculiarly dangerous innovation that needed to be vigorously suppressed. But in truth, there could be little support for it in a commercial world that was almost completely made up of specially privileged groups such as the guilds were.

From their first appearance in English commercial and industrial life, the guilds aimed to exercise a monopolistic control over trade in the town markets. Yet this system represented a step toward freedom of trade from what had preceded it, in the sense that oligarchic control is slightly more democratic than autocratic control. We have no evidence that men were ever free to buy and sell at their own will and discretion, even in Saxon times. On the contrary, the earliest English markets of which we have certain knowledge, were markets designated by the king and established by law. Buying and selling elsewhere was prohibited, in order to prevent traffic in stolen goods. Traders in the market were required to pay tolls to the king—a reasonable requirement, since they enjoyed his protection. These original features of markets—that they were held only in designated places at stated times, that trading outside them was prohibited, and that traders in them must pay toll—persisted long after some of the reasons for them had disappeared. Naturally the tolls assumed increasing importance. The lords, spiritual and temporal, who obtained from the king the rights to various town markets, enjoyed a rich revenue from them. In a few instances, at least, this revenue has continued down to very recent times, for the status of some markets remained substantially unchanged to the latter part of the nineteenth century.

During the eleventh and twelfth centuries, however, a large number of towns purchased their freedom from the king or lord for a fixed annual rent. Some of them had little difficulty in doing this; others, particularly those manors belonging to lords of the church, were less fortunate. The abbots and priors were reluctant to allow any powers to pass from their hands, and even when they yielded, they sometimes retained certain specific tolls such as the market-tolls or milling-tolls. More than a hundred towns, however, were free before the end of the thirteenth century.

An almost universal phenomenon in these was the organization (or recognition) of a Guild Merchant. Usually the *Gilda Mercatoria* was expressly permitted by a clause in the charter. This type of guild (presumably borrowed from Normandy and Flanders) was the first to exercise any important influence in the commercial development

of England. There were English guilds for social and religious purposes earlier, and perhaps a few guilds of craftsmen (such as those of the weavers in Oxford and the bakers in London), but the Merchant Guilds were the first large-scale application of guild principles to business. Directly or indirectly, they controlled a large proportion of the town markets during the twelfth and thirteenth centuries. The term *Guild Merchant* is a somewhat misleading translation of *Gilda Mercatoria*. "Trader's Guild" would perhaps picture it more accurately. Few of the members were merchants in any modern sense of the word. They included butchers, bakers, brewers, and all sorts of craftsmen who produced articles for sale. Direct marketing from producer to consumer was considered the ideal, and the growth of a distinct class of middlemen was viewed with distaste. "Regrating" (speculative buying for resale in the same market) was a serious offense as was "forestalling" (buying outside the market). The fact that the markets were held only at periodic intervals (usually once a week) made it possible for those engaged in production to do their own selling. Nevertheless, as towns grew and a greater quantity and variety of commodities became available, a class of middlemen gradually came into being; but they never became numerous enough to constitute the entire membership of a Guild Merchant.

The preferential position of the members of a Guild Merchant in a town market is faintly paralleled by that of the members of a Produce or Cotton Exchange to-day. But the Guild Merchant was a more closely knit organization. The members were bound in bonds of brotherhood, and each one was pledged to share his bargains with his fellows. Those who were not members, the outsiders or *forinseci,* could not sell in the town market except on stated terms which discriminated against them severely, and, in fact, were sometimes virtually prohibitive. Only in the annual fairs, which remained among the king's prerogatives (though often conferred by him on some religious or charitable establishment), was there any approach to equality among the traders. This partly explains why the fairs became so popular, and why they were viewed with jealousy by many towns. In fact, London tried for a time to boycott Stourbridge Fair, but without success.

It may therefore be seen that, in its earliest wide-spread manifestation, the guild principle in English commerce meant control of the town market by an oligarchy of traders. The market regulations were no less strictly enforced than they had been under the king or lord; indeed they were probably more strictly enforced, for there were more persons to watch for violations, and unwilling for economic reasons to wink at them. The market monopoly of the Guild Merchant

was of a relatively innocuous kind, so long as practically all the substantial citizens were members. Nevertheless, this selfish exclusion of outside blood would scarcely commend itself to a modern Chamber of Commerce as a means of increasing the growth or prosperity of a town.

During the fourteenth century the Guild Merchant almost everywhere ceased to be the dominant power in the town markets. This does not appear to have been due to any dissatisfaction with their policy, but rather due to the fact that their membership had grown too unwieldy and too diverse in interests for effective administration. Craft Guilds were formed in the more important trades, subsidiary to the Guild Merchant and under its regulation. Little vitality remained in the Guild Merchant, though it seems to have continued its existence. As late as 1817, a druggist in York was prosecuted (unsuccessfully) for selling imported goods without a license from the Merchant Guild of the town. Perhaps in a few towns the old Guild Merchant developed into a guild of merchants proper, the Mercers Guild, or even into a fellowship of Merchants Adventurers, later to become a component element of the great company of Merchants Adventurers of England. The fact that the Company of Merchants Adventurers of Newcastle had in their possession charters granted to the Guild Merchant of that town has been cited as proof of such a connection. Newcastle, however, was a leading seaport, and her Guild Merchant may have contained a group of merchants even at its beginning in the reign of King John.

In most cities the Guild Merchant disappeared, without leaving any living organization that could claim to be its sole heir. Instead appeared a group of craft guilds, which became the chief forces controlling the markets and trade of the towns. In York in 1415, fifty-seven crafts were recognized. Other cities also had a large number. In London, naturally, the craft-guild system had its most extensive and elaborate development. London seems never to have had the transition stage of the Guild Merchant, possibly because the number of persons eligible was so great that this would have been unwieldly at the start; but practically every important trade, craft, and commercial occupation was organized into a guild.

Perhaps because of their name, perhaps because of the attractive theory on which they are based, the craft guilds have acquired a romantic and idealistic halo which they do not altogether deserve. It is true that they aimed at a high standard of workmanship and prescribed a lengthy apprenticeship to secure it. At bottom, however, the Craft Guild, like the Merchant Guild, embodied the medieval idea

of combination and acquisition of special privilege. In short, it was a form of trade monopoly. Some of the most powerful of the London guilds, such as the Fishmongers and Grocers (the "victualling guilds") were not composed of craftsmen in the true sense of the word, as was scornfully pointed out to them by the Drapers. Their apprenticeship system was less concerned with insuring quality of their personnel than with limiting its quantity. One indication of this is the fact that a man who had served his apprenticeship in one craft or "mystery" was sometimes permitted to engage in another.

The craft guilds were usually organized under the name of some patron saint and made some pretensions to religious activities, but this was well understood to be mainly a pretext. They bickered with one another regarding their industrial jurisdiction and their precedence at feasts and celebrations. They fought with one another for political power and spoils. The history of the Fishmongers Company in London politics is at least as unsavory as that of Tammany Hall in New York. Even those guilds which had a genuine ideal of craftsmanship were frequently concerned largely in protecting themselves against competition. Their Committees of Standards found it possible to condemn and destroy competing merchandise brought in from outside. By this and other methods they erected a Chinese Wall of protection around their city. Not always did it have the result they intended. Occasionally it happened that industries cramped by the supervision of the guilds emigrated to the country districts. The great cloth-industry, for example, became largely a country industry, in spite of desperate efforts by various towns to retain it.

One instance of craft-guild policy which illustrates the method is of special interest because it involves Richard Schilders, printer of the first edition of Wheeler's *Treatise of Commerce*. Schilders was admitted to the Stationers Company of London as a foreign brother. In 1578 he was brought before the court of the Company on the charge that he was printing a pamphlet, contrary to the rules governing foreign members. He was ordered to turn the partly completed job over to another member and to work for him as a journeyman at weekly wages. Evidently this did not satisfy Schilders' ambition, for a few years later he bobbed up as a printer in Middelburg, where he became famous as a printer of some of the most beautiful and most important English books of the period. Obviously, the restrictions upon his liberties in England deprived the Stationers Company of a member who would have added considerable lustre to their history. The Stationers Company could furnish us many other evidences of the imperfections of the guild system. They parceled out the profitable

jobs to favored members. They limited the size of editions so as to insure furnishing more labor in typesetting and printing. Their philosophy and that of most other guilds seemed to be that demand was inelastic and therefore the road to profits was through rigid control and limitation of supply.

17

THE STOURBRIDGE FAIR

DANIEL DEFOE

HAVING BEEN AT STOURBRIDGE FAIR when it was in its height in the month of September, I must say, that it is not only the greatest in the whole Nation, but I think in Europe. It is kept in a large cornfield, near Casterton, extending from the side of the River Cam, towards the Road, for about a half-mile square.

If the Field be not cleared of the corn before a certain day in August, the Fairkeepers may trample it under-foot, to build their Booths or Tents. On the other hand, to balance that Severity, if the Fairkeepers have not cleared the Field by another certain day in September, the Ploughman may re-enter with plough and cart, and overthrow all the dirt; and as for the Filth, Dung, Straw, etc., left behind by the Fairkeepers, which is very considerable, these become the Farmers' Fees, and make them full amends for the trampling, riding, carting upon, and hardening the ground.

It is impossible to describe all the Parts and Circumstances of this Fair exactly; the Shops are placed in Rows like Streets, whereof one is called Cheapside; and here, as in several other Streets, are all sorts of Traders, who sell by Retale, and come chiefly from London. Here may be seen Goldsmiths, Toymen, Brasiers, Turners, Milaners, Haberdashers, Hatters, Mercers, Drapers, Pewterers, Chinawarehouses, and,

in a word, all Trades that can be found in London; with Coffeehouses, Taverns, and Eating-houses in great Numbers; and all kept in Tents and Booths.

In the place peculiar to the Wholesale Dealers in the Woolen Manufacture, the Booths or Tents are of a vast Extent, having different Apartments, and the Quantities of goods they bring are so great, that the Insides of them look like so many vast Warehouses piled up with Goods to the Top. In this Duddery, as I have been informed, have been sold 100,000 Pounds-worth of Woolen Manufactures in less than a Week's Time; besides, the prodigious Trade carried on here by Wholesalemen from London, and all Parts of England, who transact their Business wholly in their Pocketbooks; and meeting their Chapmen from all Parts, make up their Accompts, receive Money chiefly in Bills, and take Orders. These, they say, exceed by far the Sales of Goods actually brought to the Fair, and delivered in Kind; it being frequent for the London Wholesalemen to carry back Orders from their Dealers, for 10,000 Pounds-worth of Goods a Man, and some such more. This especially respects those People who deal in heavy Goods, as Wholesale Grocers, Salters, Brasiers, Iron Merchants, Wine Merchants, and the like.

In the Duddery I saw one Warehouse, or Booth, consisting of six Apartments, all belonging to a Dealer in Norwich Stuffs only, who, they said, had there above 20,000 Pounds Value in those Goods.

But all this is still outdone, at least in Appearance, by two Articles which are the Peculiars of this Fair, and are not exhibited until the other Parts of the Fair, for the Woolen Manufacture, begins to close up: these are the WOOL, and the HOPS. There is scarce any price fixed for Hops in England till they know how they sell at Stourbridge Fair. The Quantity that appears in the Fair is indeed prodigious, and they take up a large Part of the Field, on which the Fair is kept to themselves; they are brought directly from Chelmsford in Essex, from Canterbury and Maidstone in Kent, and from Farnham in Surrey; besides what are brought from London, of the Growth of those and other Places.

To attend this Fair, and the prodigious Crowds of People which resort to it, there are sometimes no less than 50 Hackney Coaches, which come from London, and ply Night and Morning to carry the People to and from Cambridge; for there the Gross of them lodge; nay, which is still more strange, there are wherries brought from London on Waggons, to ply upon the little River Cam, and to row People up and down, from the Town, and from the Fair, as Occasion presents.

18

THE USE OF STATISTICS

SIR GEOFFREY HEYWORTH

The reason why the business man is not much interested in theory is that he wants figures, not for the advancement of knowledge or for their scientific interest, but only as a help in deciding what he ought to do next in the running of his affairs, and it is this fact which lies behind all the points I hope to make.

They are three. First, that business statistics have to be simple; second, that they should be made available in any business only to those who can take useful action on the basis of them and not to everybody who may be interested in them; and, third, that they are useful only as a check on, not a substitute for, the business man's judgment.

All three follow from the proposition that the primary purpose of business figures is to provide information on which the business can make its decisions. When a business man uses his figures for a theoretical purpose, he has, for the time being, ceased to be a business man and become an economist.

This close connection between figures and the action which follows on them distinguishes business statistics very clearly from those of a research body and from most of the statistics published by the government. They publish their figures for general use. They, therefore, have to be able to stand up to the scrutiny of a wide public who may criticize them from many different points of view, and who may use them for purposes in which very different margins of error are tolerable.

They have, therefore, to be accurate, or if they are not accurate, this fact has to be made quite clear to the reader; they have also to be free of avoidable ambiguity. Finally, they have to recognise that most of the people who read them do so only to provide themselves

with a background of general knowledge. They often do not propose to do anything at all, and they very rarely propose to do anything immediate, as a result of what they learn.

The sort of figures one collects in a business, the accuracy one demands and the circulation which one gives them all depend upon the one crucial test. The figures can only provide facts on which judgment is exercised. They cannot replace judgment. Indeed, without a business man's own knowledge and experience the figures are frequently meaningless and almost always misleading.

The test of the proper use of business statistics, therefore, is always the skill with which the user combines his own knowledge with the raw figures to produce the finished judgment. There is no substitute for managerial judgment. All statistics can do is to reduce the chance of error inherent in managerial ignorance or prejudice.

19 ·

SHOPPING IN 1709 IN LONDON

THIS AFTERNOON some ladies, having an opinion of my fancy in cloaths, desired me to accompany them to Ludgate-Hill, which I take to be as agreeable an amusement as a lady can pass away three or four hours in. The shops are perfect gilded theatres, the variety of wrought silks so many changes of fine scenes and the mercers are the performers in the opera. . . . They are the sweetest, fairest, nicest dished-out creatures; and by their elegant address and soft speeches, you would guess them to be Italians. As people glance within their doors, they salute them with—"Garden silks, ladies, Italian silks, brocades, tissues, cloth of silver, or cloth of gold, very fine mantua silks, any right geneve [?Genoa] velvet, English velvet, velvet embossed." And to the

meaner sort—"Fine thread satins, both striped and plain, fine mohair silk, satinnets, burdets, Persianets, Norwich crapes, anterines, silks for hoods and scarves, hair camlets, druggets or sagathies, gentlemen's night-gowns ready made, shalloons, durances, and right Scotch plaids."

We sent into a shop which had three partners: two of them were to flourish out their silks; . . . the other's sole business was to be gentleman usher of the shop, to stand completely dressed at the door, bow to all the coaches that pass by, and hand ladies out and in. . . . When we had pleased ourselves, and bid him ten shillings a yard for what he asked fifteen: "Fan me ye winds, your ladyship rallies me! Should I part with it at such a price the weavers would rise upon the very shop. Was you at the Park last night, madam? Your ladyship shall abate me sixpence. Have you read the *Tatler* to-day?" etc.

These fellows are positively the greatest fops in the kingdom; they have their toilets and their fine night-gowns; their chocolate in the morning and their green tea two hours after; turkey polts for their dinner, and their perfumes, washes and clean linen equip them for the parade.

20

COLONIAL ECONOMY, 1711

THE REVEREND JOHN URMSTONE

Workmen are dear and scarce. I have about a dozen acres of clear ground, and the rest woods, in all, three hundred acres. Had I servants and money, I might live very comfortably upon it, raise good corn of all sorts, and cattle without any great labor or charges, could it once be stocked; but for want thereof shall not make any advantage of my land. I have bought a horse some time ago; since that, three cows and

calves, five sheep, and some fowls of all sorts, but most of them unpaid for, together with fourteen bushels of wheat, for all which I must give English goods. At this rate I might have had anything that either this government or any of the neighboring colonies afford. But had I stock, I need not fear wanting butter, cheese, beef, mutton, of my own raising, or good grain of all sorts. I am forced to work hard with axe, hoe, and spade. I have not a stick to burn for any use, but what I cut down with my own hands. I am forced to dig a garden, raise beans, peas, etc., with the assistance of a sorry wench my wife brought with her from England.

Men are generally of all trades, and women the like within their spheres, except some who are the posterity of old planters, and have great numbers of slaves, who understand most handicraft. Men are generally carpenters, joiners, wheelwrights, coopers, butchers, tanners, shoemakers, tallow-chandlers, watermen, and what not; women, soap-makers, starch-makers, dyers, etc. He or she that cannot do all these things, or hath not slaves that can, over and above all the common occupations of both sexes, will have a bad time of it; for help is not to be had at any rate, every one having business enough of his own. This makes tradesmen turn planters, and these become tradesmen. No society one with another, with all study to live by their own hands, of their own produce; and what they can spare, goes for foreign goods. Nay, many live on a slender diet to buy rum, sugar, and molasses, with other such necessaries, which are sold at such a rate that the planter here is but a slave to raise a provision for other colonies, and dare not allow himself to partake of his own creatures, except it be the corn of the country in hominy bread.

21 · THE MATURE ECONOMY

THE AUTOMOBILE AND BUILDING INDUSTRIES' prodigious new production records in 1950 of 8 million passenger cars and trucks and over 1⅓ million new dwelling units recall to mind an old bogey that was worrying a good many people not so many years ago—the theory that the country had grown "mature" and that there were no longer the "new frontiers" for employment of capital and labor in dynamic growth there had been in the past. People recalled how the boom in railway construction had carried the country forward in the latter part of the 19th Century. They pointed to the mushrooming development of the automobile industry as the mainstay of the prosperity of the '20s. They asked despairingly where were the new industries comparable to these to provide employment for the growing resources of capital and manpower and to prevent economic stagnation.

The literature of the '30s is replete with these forebodings. Thus in the proceedings at the annual meeting of the American Economic Association in December 1938 we find the following expression (it may be charitable to omit the speaker's name):

> It is my growing conviction that the combined effect of the decline in population growth, together with the failure of any really important innovations of a magnitude sufficient to absorb large capital outlays weighs very heavily as an explanation for the failure of the recent recovery to reach full employment.

In a similar vein is the following excerpt from another paper read at the same meeting:

> Should new industries fail to materialize in sufficient volume to demand large private capital outlays, a continued expansion of the demand for capital goods appears to be contingent on the assumption of large responsibilities by local, state and federal governments to provide for the expansion of investment.

During World War II, when the nation's industries were largely converted to the production of military supplies and other goods essential to winning the war, there was much discussion of plans for new postwar products—many of them only in the "dream" stage—that might help to sustain business after the fighting ended. The *Wall Street Journal* in an editorial on August 7, 1944 expressed the prevalent question as follows:

> After the last war, the rapid development of the automobile industry led the country to unprecedented prosperity. What industry is in sight to take the leadership now?

The editorial went on to say that the leaders in the automobile industry seemed to be offering an answer to the question, and that the answer was simply this: "The automobile industry."

The past few years have given dramatic confirmation to this prediction. It was not the great new industry that the economic observers of the '30s were so anxiously scanning the horizons for to take the leadership, but our old friend the automobile industry, together with the age-old enterprise of building.

New industries, it is true, there have been in plenitude—television, plastics, synthetic rubber and textiles, new discoveries in chemicals and in countless other directions—and they have contributed mightily to the creation of new jobs and new wealth. But it has been the automobile industry, together with home building, that emerged as the outstanding factor supporting general business prosperity—the same as took place after World War I—and made a mockery of the term "mature economy." The worry today is that these industries are hitting too fast a pace, in view of the need of conserving materials for the defense program.

AUTOMOBILES, 1929-1950

How the automobile industry has forged ahead is strikingly illustrated by preliminary figures for 1950 given out recently by the Automobile Manufacturers Association. The following table shows the growth since 1929, the old prewar production peak:

COMPARISON OF AMERICAN AUTOMOBILE INDUSTRY, 1929-1950

		1929	1950	% Change
Production—Numbers				
Passenger cars	(Thousands)	4,587	6,666	+ 45
Trucks and buses	"	771	1,337	+ 73
Total	"	5,358	8,003	+ 49
Production—Wholesale Value				
Passenger cars . . .	(Millions)	$2,847	8,825	+210
Trucks and buses	"	566	1,670	+195
Total . .	"	3,413	10,495	+208
Motor Vehicle Registration				
Passenger cars	(Thousands)	23,060	39,710	+ 72
Trucks and buses .	"	3,442	8,770	+155
Total	"	26,503	48,480	+ 83
Employed in Automobile and Parts Industry				
Total employment .	(Thousands)	518	840	+ 62
Production workers only:				
Number	"	471	715	+ 52
Payrolls	(Millions)	$ 789	$2,700	+242
Average weekly earnings		$32.20	$72.85	+126
Average weekly hours .		46.8	41.2	— 12
Average hourly earnings		$0.688	$1.765	+157
Special Motor Vehicle Taxes				
State and local ..	(Millions)	$ 850	$2,880	+239
Federal excise	"	...	1,440	+ . .
Total . . .	"	$ 850	$4,320	+408
Highway Expenditures				
Federal, state and local	(Millions)	$2,194	$4,000	+ 82
Gasoline Consumption by Motor Vehicles				
.... .	(Million gallons)	14,139	35,600	+152

Source: Automobile Manufacturers Association; 1950 figures preliminary.

Between these two years production of passenger cars and trucks increased from around 5.3 million to 8 million, or by 49 per cent over the old peak. As compared with the low years of the late '30s, when people were talking about the "mature economy" and the "saturation point" for automobiles, production has more than doubled.

Registration of motor vehicles hit a peak of over 48½ million in 1950. In 1929 the registration was 26½ million, and in 1909 it was but 312,000. The United States, with only 6 per cent of the world's population, has 77 per cent of the world's cars and 52 per cent of the trucks. More than 73 per cent of all families in this country now own cars.

Expansion in automobile production has been both cause and effect of similar growth in a host of important related industries, such as the manufacture of parts, tires, batteries, etc., petroleum refining, auto sales and servicing, construction and maintenance of over 3 million miles of public roads, financing automotive products all along the line, liability and other insurance coverage, motels and tourist camps, and—last though by no means least—the collection of taxes.

Special taxes collected from motor vehicle users in 1950 included state registration receipts of $905 million, state gasoline taxes of $1,725 million, city and county taxes of $100 million, toll charges of $150 million, and federal excise taxes of $1,440 million—a total of $4,320 million. And this does not include the regular corporate and individual income, property, and sales taxes paid by the thousands of concerns and by the millions of people engaged in producing, distributing, servicing, and operating motor vehicles.

By its continuous improvements in methods of mass production and its tremendous investments of new capital for better plants and equipment, this industry has been able not only to make America a nation of car owners, but in the process to provide jobs for more and more people, to increase wages and at the same time to shorten working hours.

NEW FRONTIERS IN HOME BUILDING

Similarly, we have been discovering "new frontiers" in home building. Back in the '30s economic pundits were talking about the decline in population growth, with its retarding effect on home building, as one of the symptoms of our "mature economy."

That time has not borne out this prediction is evident from the record total of more than 1⅓ million new dwelling units started in 1950, as against 937,000 in 1925. While this showing is partly the result of the Government's extraordinary liberality in financing home building, it has been due also to the fact that people born in the 'twenties,

when birth rates were relatively high, have been reaching home-seeking ages. Not only has home building had to make up for low levels of building during the war and the preceding depression, but it has been a natural reflection of the general state of prosperity, the desire of the people for better homes, and the great strides made by the building industry, including suppliers of materials and fixtures, in adapting new home construction to modern living requirements.

In other words, it's another example of the old American story of growth and progress in supplying the people with what they want.

THE LESSON

The lesson of this experience is clear. We don't have to pin our hopes on some "great new industry" coming along every so often to keep us employed and moving ahead.

Important as are the discoveries that open new industrial trails, progress comes also from the constant evolution and improvement in the older industries where scientific invention and aggressive leadership bring about changes of such sweeping character as to be tantamount to creation of whole new industries. Since the end of World War II the supposedly "mature" automobile industry has invested over $2 billion of new capital in reconversion, modernization, and expansion of facilities. And still this industry keeps renewing its youth; one large company alone—Ford Motor—has announced plans to spend $1 billion more during the next three years.

Today as we look back on the anxieties and doubts of the '30s, we can recognize the old familiar pessimism of hard times. The '30s were not the first time that Americans have prophesied that opportunities for growth and development had come to an end, only to have their statements look foolish by what came after.

The important thing is in preserving the spirit of enterprise which has overcome obstacles and enabled our economy to rise to new heights after every setback. The great danger now, as we face the expanding national defense program, is in smothering this spirit with taxes and controls over both business and individual life. While higher taxes and more controls are inevitable in this emergency, we must guard against carrying them to the point of holding back industrial growth. In the present international situation, much more than the question of a "mature economy" is at stake. Our very survival depends as much upon constant improvement in the productivity and efficiency of our industries as upon the defense program itself.

22 ·

CONSERVATION: WATER-RESOURCES POLICY

THROUGHOUT HISTORY, water has dominated human life. The earliest civilizations appeared in the great river basins of Mesopotamia and Egypt. Settlements were limited to coast lines and river banks; trading centers arose at the confluences of navigable streams.

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Until recent times, man has not attempted to control water, except in a limited measure for water supply and irrigation. He has for the most part been forced to adjust his ways to its vagaries as nature gave or withheld rain for his crops or overwhelmed him with raging floods. Prayer, magic, and propitiation marked his early gropings for control.

Today, on the American continent, centuries of human history coexist. On their western lands, Indian rain makers dance their age-old dances while overhead airplane pilots are seeding the clouds.

The attempt to use science and technical skill to force water from the clouds is symbolic of the modern determination to control and use water, rather than to submit to it.

It is an expression of the same scientific determination to use the forces of nature to serve man's purposes as is embodied in such great river basin programs as that for the Columbia, which will ultimately provide 50 million horsepower and bring millions of new acres under cultivation.

In the brief span of a century and a half, American farms and cities have spread over the land from the Appalachians to the Pacific. Great harbors have been built, navigable streams maintained and improved; large cities have been supplied with adequate quantities

of pure domestic water, their wastes carried away by more water; in the arid and semiarid West, deserts have been made to bloom; and large and small dams provide for flood control, hydroelectric power, and irrigation. All these things are the achievements of human ingenuity and enterprise—the work of many pioneering individuals, many men of technical skill, and the cooperation of local, State, and Federal Governments.

On the debit side, man's activities in exploiting nature also have been destructive. We have used water badly, without proper respect for its natural cycle, turning it from a friend to an enemy. We have destroyed forests, leaving barren, denuded mountainsides from which rain water and melting snow pour unchecked; we have overplowed and overgrazed our lands; we have dangerously increased soil erosion, allowing precious topsoil to be carried to the sea, muddying our streams, filling up our reservoirs, and increasing the damage from floods.

* * * *

Now, midway in the twentieth century, two facts have become compellingly clear.

The first is that water is limited in relation to the many and varied needs for its use. These needs will grow in size and complexity as the population grows and as industry develops. More water for domestic use is needed by our growing towns and cities. More water must be used to bring new lands into production in the West. New industrial techniques, such as those developed in the chemical industries, synthetic fuel production, and the harnessing of atomic power, bring with them increasing demands for water.

We can no longer be wasteful and careless in our attitude towards our water resources. Not only in the West, where the crucial value of water has long been recognized, but in every part of the country, we must manage and conserve water if we are to make the best use of it for future development.

The second fact we can now see clearly is that the management, conservation, and use of our water resources is inextricably bound up with the management, conservation, and use of our land and that both are essential to our expansion as a Nation. Floods cannot be controlled by building higher and higher levees, or permanently by building dams, if other things are neglected. The big streams are fed by small streams, and water control inevitably leads us back to the proper conservation of forests and agricultural land.

The farmer who holds the rain water by terracing his fields, the group of farmers who band together to form a soil conservation dis-

trict, play an indispensable role in water management. The preservation of our forests, our mountain lakes and streams, and our wildlife sanctuaries has ample justification in providing healthful sport and recreation for the refreshment of the human spirit; but it is also an essential part of water conservation and management. In short, if we do not manage and conserve water, we suffer losses, some of them irreparable, in our other natural resources. If we do not manage and conserve these other resources, we shall lose the usefulness of our water: it will rush to the sea, robbing instead of enriching us.

A well-rounded national water resources policy to meet this need must be a broad reflection of the lives of the people on their farms, in their villages and cities, in their regions, and in the Nation as a whole. Civilizations are built on a combination of water, land, and people. When the combination ceases to be infused with a moral relationship between man and man, and man and nature, civilizations decline and give place to new combinations of these elementary values.

The people will drink the water, use it on the land to grow crops, feel the destructive power of uncontrolled floods, learn to use water more intelligently to avoid destruction of the land. They will transport their bulk cargoes on the bosom of streams, perform a multiplicity of tasks with the aid of electric power generated by falling waters, utilize water in their industrial processes, resent its pollution, and enjoy the fishing, boating, swimming, and other forms of recreation offered by the clean waters of lakes, reservoirs, ponds, and streams.

* * * *

Meanwhile, the expanding cities and industrial plants began to overload the streams with their wastes, thus causing pollution which gradually rendered them unfit for beast, bird, fish, or man. Water treatment and pollution control became imperative.

Electric power gave the final impetus to the transition to our modern industrial economy. Each tumbling rapids or waterfall on a stream, whether large or small, became a source of the great energy of modern times, electricity. In the early years non-Federal interests developed the most economical water power sites, constructing projects designed for the single purpose of producing and selling hydroelectric power. But a rising recognition of the many purposes which dams and reservoirs could serve and the approach of the time when huge water power potentials could be tapped only through Federal multiple-purpose basin undertakings led to the development of Federal power policy as an integral part of water resources policy.

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The rise of water resources policy to meet ever-changing conditions provides one of the great examples of the effectiveness of a democratic society in meeting the widely varying needs of its people.

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The most important key to the evolution of that policy has been increasing recognition of comprehensive development of an entire river system for many purposes, as the means of achieving public objectives in the use of water and associated land resources. The evolution has taken policy from the earlier single-purpose, single-project approach, through the period of comprehensive single-purpose programs, including many projects in the same basin, to the present state of law governing most water resources planning. This provides for comprehensive planning, in which a number of purposes are subordinate to a specified principal purpose such as flood control, navigation, or irrigation.

* * * *

There is today no single, uniform Federal policy governing comprehensive development of water and land resources. Some statutes of uniform application separately control various aspects or functions. Others are geared to a comprehensive approach, but focus attention on individual projects, specific areas, or single river basins. Insofar as it may now be achieved, therefore, comprehensive development of river basins must depend upon a number of statutes passed at different times, devoted to individual segments of basin development and administered by separate executive agencies.

Efforts have been made to deal with this lack of unity through governmental reorganization. So far the recommendations along this line have not been accepted.

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Long before there was legislation contemplating comprehensive multiple-purpose basin programs, Congress was recognizing the interrelationships between the functions which were ultimately to compose such programs. First it recognized the relationship between navigation and flood control in 1879; then in 1888 the relationship between irrigation and flood control; 9 years later, in 1897, the relationship between forest cover and flood control, navigation, and irrigation. Finally, in 1906, the General Dam Act recognized the relationship among power, navigation, and fish, while an amendment to the Reclamation Act provided for disposal of surplus power at reclamation projects.

* * * *

The report of the Conservation Commission, issued in 1909, laid down a policy which can be merely amplified, not improved, in the breadth of its understanding of basic principles. It said:

> Broad plans should be adopted providing for a system of waterway improvement extending to all uses of the waters and benefits to be derived from their control, including the clarification of the water and abatement of floods for the benefit of navigation; the extension of irrigation; the development and application of power; the prevention of soil wash; the purification of streams for water supply; and the drainage and utilization of the waters of swamp and overflow lands.
>
> To promote and perfect these plans scientific investigations, surveys, and measurements should be continued and extended, especially the more accurate determination of rainfall and evaporation, the investigation and measurement of ground water, the gaging of streams and determination of sediment, and topographic surveys of catchment areas and sites available for control of the waters for navigation and related purposes.

The report of the Conservation Commission was promptly approved by a Joint Conservation Conference, including governors of 20 States and Territories, and representatives of 22 State conservation agencies, of 60 national organizations, of Federal agencies, and of the Conservation Commission itself.

But it was not until 1933, more than 20 years later, that Congress authorized a large-scale effort to treat river basins as units for purposes of development. This has developed the conflicts and confusion which always attend the effort to put new wine into old bottles. With the exception of the TVA Act, the legislative and administrative set-up has not been conducive to full development of the unified basin programs which these early conservationists contemplated.

Meanwhile, as new needs developed and with them our understanding of the interrelationships of all aspects of land and water management, the necessity to consider whole river basins with their tributaries, including the many brooks, ponds, lakes, and basins of their little waters, has become increasingly apparent. The ideas of conservation, and of multiple-purpose projects, began to pose new problems of coordination, if wastes and cross-purposes were to be avoided.

Irrigation and drainage, navigation and flood control, the maintenance of underground water levels, the control of stream pollution resulting from human, animal, and industrial wastes, the generation of electric power, the protection of salmon and other fish resources,

the provision of ample domestic water supply—all these purposes have legitimate claims within any one basin; but if one is developed without regard for its effect on the others, conflicts and losses will result.

Comprehensive, long-range plans must be worked out within each river basin. But a river basin is still not the final unit in an adequate use and conservation plan. The Federal Government has a substantial investment in existing water resources improvements; it will spend in 1951 another 1.2 billion dollars; it has authorizations amounting to 12 billion dollars in the years just ahead. These expenditures will be made for the good of the Nation as a whole; and nothing less than the whole country can be the unit considered in the formulation of Federal policies.

* * * *

Our population is growing, and will reach an estimated 190 million in about 25 years. Merely to maintain our present standards of living, therefore, we shall need to husband our water resources and use them to irrigate the fields and produce the power required to meet the needs of increasing numbers of people.

But the goal of the American economy has never been static. It is, and will continue to be, dynamic. We have achieved, and expect to achieve in the future, a constantly rising standard of living for a growing population.

There are no new physical frontiers, no new lands or forests to exploit. Indeed, some of our natural resources have been lost through careless and wasteful exploitation. Today, the problem of economic advance has been expressed as "to make more and more out of less and less." There are immense and inspiring possibilities of continued expansion and advancement; but the new frontier we must explore is not merely physical. It lies in the realms of knowledge and skill, and the wisdom with which we as a people can cooperate to apply them. We need much greater knowledge, determination, and foresight than our fathers needed in order to fulfill the promise of American life. That promise is as great for us as it was for them. The wise development and conservation of our key resource, water, is essential to further economic progress.

But provision of opportunities to achieve higher levels of material well-being for a growing population is not the sole measure of Federal responsibility. Even more important is the fact that on the strength and dynamism of the American economy rests the main hope of achieving world peace and freedom.

We are committed to a titanic contest in which proper utilization

of our resources may prove the ultimate determinant of our strength. All our skill, enterprise, and political wisdom will be needed to meet that challenge, not only for ourselves, but in defense of human freedom everywhere.

It cannot be too strongly emphasized that planning, for the United States, must mean not rigidity, but intelligent flexibility; not dictatorship and centralization, but cooperative and shared responsibility. The American system succeeds only as it encourages initiative, enterprise, and a sense of responsibility for the common good. No "plan" can be acceptable which weakens or fails to use these qualities. The recommendations of this report do indeed envisage long-range plans for each river basin, and an over-all water resources plan for the Nation as a whole. But both in the detailed formulation of these plans and in their operation, individual farmers, workers, and businessmen, as well as agencies of local, State, and Federal Government, will play an indispensable and fully responsible part.

* * * *

When multiple-purpose dams are built with Federal funds, the Federal Government enters the field of economic enterprise. The justification for this is beyond question. No other agency can command sufficient capital resources or provide the coordination necessary for the construction of these great programs. But Government enterprise does not in any way supplant private enterprise. Rather its purpose is to create the over-all conditions, the framework, in order to provide the opportunity for the further expansion and healthy functioning of a free, competitive economy.

In other words, "planning" in the American sense means planning to maintain and strengthen free competition. Where natural monopolies exist, therefore, it is in accordance with the American system that the Government should itself provide competition, if this is deemed necessary to insure its benefits, as for example by providing low-cost and abundant power. But it is not in accordance with the American system, nor is it any part of the purpose of the plans for water development proposed in this report, that the Federal Government should itself become a great monopolist.

The sums which the Federal Government has already invested and will in the future invest in water resources development are a substantial factor in the total Federal budget, and in the total national economy.

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The magnitude of the sums involved in Federal water resources development make it necessary, in the interest alike of efficient development and economic stability, for expenditures to follow an orderly, long-range plan. Whatever the merits of public works programs as an aid in minimizing cyclical fluctuations in the field of business, it is undeniable that clearly defined commitments will contribute to stability. A well-defined Federal investment program, with elements of flexibility, can allow for expansion and contraction in periods of depression and inflation.

23 ·

MATERIALS FOR STEEL MAKING

DOUGLAS A. FISHER

TWO PRINCIPAL FACTORS have determined where America's steel making centers are situated. The first and most important factor is the location of iron ore, coal and limestone deposits. More than four tons of these raw materials are required to produce a ton of steel. The second is the nearness to manufacturing industries which buy steel products from the mills.

Let us first consider raw materials and steel centers in the northeastern section of the United States. . . . [The] largest deposits of raw materials are located in widely separated regions. The iron mines are in northern Minnesota, Michigan and Wisconsin. One large area of coking coal deposits stretches from Pennsylvania and Ohio down through a number of Southern states. Another coal area embraces Indiana, Illinois and part of Kentucky. A third coal region in the Middle West extends from southeast Kansas through parts of Okla-

homa and Arkansas. However, deposits of the richest coal are in Pennsylvania, Ohio, Indiana, Illinois, Virginia, West Virginia and Kentucky, which roughly supply 88 per cent of all the coal mined in this country. These seven states are the chief sources of coking coal for the steel industry in the northeastern section of the United States. Limestone quarries . . . are located in Michigan, Pennsylvania and Ohio.

These raw materials must be mined and quarried and brought together in one place. To do this, one or more of the materials generally must be hauled a long distance by boat or railroad, or by both, involving considerable cost. Because more coal than iron ore is used by steel mills and other industries which buy steel, and because the latter industries are located close to coal fields for accessibility to their source of power, it is generally more advantageous to build steel mills nearer coal areas than iron mines. For these reasons, steel makers have found it to be practical and economical to assemble their raw materials on the southeastern shores of the Great Lakes and a little farther south. That is why so many steel mills in northern United States are located in Illinois, Indiana, Ohio, New York and Pennsylvania. Seaports in Maryland have led to the establishment of steel mills in that state. These six states today manufacture 80 per cent of all the steel made in this country. The western part of Pennsylvania has proved to be a convenient center for steel mills because of nearness to coal fields and limestone quarries, and the availability of iron ore. That accounts for the great steel city of Pittsburgh.

The second important reason why steel mills are so largely centered in the six states previously mentioned is because the mills are near the markets for their products in the densest manufacturing area of the United States. It can also be said that other manufacturing industries often cluster around the source of their chief basic metal—steel. Steel centers tend to make established industrial areas grow larger.

[There are] a number of steel plants near Birmingham, Alabama. Large deposits of iron ore, coal and limestone are nearer together in that part of Alabama than in any other area of the United States. Steel products from the mills near Birmingham have been an important factor in the industrial growth of the entire South, and have contributed to increased yields of Southern agriculture.

[There are] deposits of iron ore and coal in Utah. Limestone is also found there. While these deposits are farther apart than in Alabama, it is practical to assemble them near Salt Lake City where the largest steel plant west of the Mississippi is located. Its operations are

an important phase of Utah's industrial development and represent the largest employment unit of this state. It supplies steel chiefly to Western markets. Large quantities of iron made in Utah are shipped to California where steel mills near San Francisco and Los Angeles convert it into steel products for Pacific Coast agriculture and industry.

* * * *

PART TWO

Production

This Part deals with the work of labor and management in satisfying human wants. Number 24 is the classic statement on the nature of roundabout production by Eugen von Böhm-Bawerk. Article 25, by C. F. Jones, illustrates the utilities involved in the growing and handling of cotton. The selection by Adam Smith on the advantages of division of labor (26) not only covers a subject of great significance in economic life but also serves to give an idea of the literary style of this founder of modern economics. The atomic era is considered in Selection 27 from the standpoint of its industrial potential. The selection consists of portions of speeches delivered by three members of the Atomic Energy Commission (T. K. Glennan, S. T. Pike, and H. D. Smyth) and H. A. Winne. A report by Francis Williams on Anglo-American productivity (28) and a report on cotton spinning by the Anglo-American Productivity Council (29) serve to show the differences between the American and the British economy. Thomas Robert Malthus' theory of population (30) deals with the number of human beings and the food supply. R. J. Colbert offers an analysis of the shifts in American population since 1940 (31). Labor mobility is further explained by Lloyd G. Reynolds (32). Number 33 describes the hours of labor in 1495—a sharp contrast to our 40-hour week. In Article 34 we find the Constitution and statement of purposes of the CIO; in Number 35, the Constitution of an international union, the UMWA; in Number 26, one of the most important contracts in the United States: the collective-bargaining agreement between General Motors Parts Division and the UAW. This document explains such familiar terms as *check-off, grievance, strike, time-and-a-half, double time,* and *cost-of-living allowance.* The meaning of the "Little Steel Formula" is given in Number 37 by John T. Dunlop. The basic,

and highly controversial, Taft-Hartley Law and President Truman's veto message are printed as Numbers 38 and 39. Woodrow Wilson is quoted on business success in Article 40. Curtis H. Gager calls the care and feeding of ideas "a primary function of management" in Selection 41. Selection 42 is the account by A. A. Berle and G. C. Means of the organization of property in corporate terms. Attention is given by Floyd F. Burtchett in Number 43 to the general forms of financial organization. A valuable chart by Harold G. Moulton (44) reveals the part played by financial institutions in the assembling of capital. The need and source of funds, primarily for small-business use, is considered by John M. Chapman in Selection 45. Article 46 is an explanation by the staff of Merrill Lynch, Pierce, Fenner and Beane of how to read a financial report. John C. Loeser's thorough account of the over-the-counter market (47) reveals the importance of this institution in the business world. Number 48, in a lighter vein, is a copy of a poster used many years ago to illustrate human cupidity when a get-rich-quick scheme is offered. S. S. Huebner explains the economic value of short selling (49). Charles O. Hardy's "Executing a Short Sale" (50) gives a diagram and explanation of this practice in the securities market.

Other selections which might be read in connection with this Part are Numbers 62, 68, 71, 81, 92, 106, 114, 117, 118, 119, and 120.

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24 ·

THE NATURE OF ROUNDABOUT PRODUCTION

EUGEN VON BÖHM-BAWERK

THE END AND AIM of all production is the making of things with which to satisfy our wants; that is to say, the making of goods for immediate consumption, or Consumption Goods. . . . We combine our own natural powers and natural powers of the external world in such a way that, under natural law, the desired material good must come into existence. But this is a very general description indeed of the matter, and looking at it closer there comes in sight an important distinction which we have not as yet considered. It has reference to the distance which lies between the expenditure of human labour in the combined production and the appearance of the desired good. We either put forth our labour just before the goal is reached, or we, intentionally, take a roundabout way. That is to say, we may put forth our labour in such a way that it at once completes the circle of conditions necessary for the emergence of the desired good, and thus the existence of the good *immediately* follows the expenditure of the labour; or we may associate our labour first with the more remote causes of the good, with the object of obtaining, not the desired good itself, but a proximate cause of the good; which cause, again, must be associated with other suitable materials and powers, till, finally,—perhaps through a considerable number of intermediate members,—the finished good, the instrument of human satisfaction, is obtained.

The nature and importance of this distinction will be best seen from a few examples; and, as these will, to a considerable extent, form a demonstration of what is really one of the most fundamental propositions in our theory, I must risk being tedious.

A peasant requires drinking water. The spring is some distance from his house. There are various ways in which he may supply his daily wants. First, he may go to the spring each time he is thirsty, and drink out of his hollowed hand. This is the most direct way; satisfaction follows immediately on exertion. But it is an inconvenient way, for our peasant has to take his way to the well as often as he is thirsty. And it is an insufficient way; for he can never collect and store any great quantity such as he requires for various other purposes. Second, he may take a log of wood, hollow it out into a kind of pail, and carry his day's supply from the spring to his cottage. The advantage is obvious, but it necessitates a roundabout way of considerable length. The man must spend, perhaps, a day in cutting out the pail; before doing so he must have felled a tree in the forest; to do this, again, he must have made an axe, and so on. But there is still a third way; instead of felling one tree he fells a number of trees, splits and hollows them, lays them end for end, and so constructs a runnel or rhone which brings a full head of water to his cottage. Here, obviously, between the expenditure of the labour and the obtaining of the water we have a very roundabout way, but, then, the result is ever so much greater. Our peasant needs no longer take his weary way from house to well with the heavy pail on his shoulder, and yet he has a constant and full supply of the freshest water at his very door.

* * * *

Yet another example. I am short-sighted, and wish to have a pair of spectacles. For this I require ground and polished glasses, and a steel framework. But all that nature offers towards that end is silicious iron ore. How am I to transform these into spectacles? Work as I may, it is as impossible for me to make spectacles directly out of silicious earth as it would be to make the steel frames out of iron ore. Here there is no immediate or direct method of production. There is nothing for it but to take the roundabout way, and indeed, a very roundabout way. I must take the silicious earth and fuel, and build furnaces for smelting the glass from the silicious earth; the glass thus obtained has to be carefully purified, worked, and cooled by a series of processes; finally, the glass thus prepared—again by means of ingenious instruments carefully constructed beforehand—is ground and polished into the lens fit for short-sighted eyes. Similarly, I must smelt the ore in the blast furnace, change the raw iron into steel, and make the frame therefrom—processes which cannot be carried through without a long

series of tools and buildings that, on their part again, require great amounts of previous labour. Thus, by an exceedingly roundabout way, the end is attained.

The lesson to be drawn from . . . these examples alike is obvious. It is—that a greater result is obtained by producing goods in roundabout ways than by producing them directly. Where a good can be produced in either way, we have the fact that, by the indirect way, a greater product can be got with equal labour, or the same product with less labour. But, beyond this, the superiority of the indirect way manifests itself in being the only way in which certain goods can be obtained, if I might say so, it is so much the better that it is often the only way!

That roundabout methods lead to greater results than direct methods is one of the most important and fundamental propositions in the whole theory of production. It must be emphatically stated that the only basis of this proposition is the experience of practical life. Economic theory does not and cannot show *a priori* that it must be so; but the unanimous experience of all the technique of production says that it is so. And this is sufficient; all the more that the facts of experience which tell us this are commonplace and familiar to everybody. But *why* is it so? The economist might quite well decline to answer this question. For the fact that a greater product is obtained by methods of production that begin far back is essentially a purely technical fact, and to explain questions of technique does not fall within the economist's sphere. For instance, that tropical lands are more fruitful than the polar zone; that the alloy of which coins is made stands more wear and tear than pure metal; that a railroad is better for transport than an ordinary turnpike road;—all these are matters of fact with which the economist reckons, but which his science does not call on him to explain. But this is exactly one of those cases where, in the economist's own interest—the interest he has in limiting and defining his own task—it is exceedingly desirable to go beyond the specific economic sphere. If the sober physical truth is once made clear, political economy cannot indulge in any fancies or fictions about it; and, in such questions, political economy has never been behind in the desire and the attempt to substitute its own imaginings! Although, then, this law is already sufficiently accredited by experience, I attach particular value to explaining its cause, and, after what has been said as to the nature of production, this should not be very difficult.

In the last resort all our productive efforts amount to shiftings and combinations of matter. We must know how to bring together the right forms of matter at the right moment, in order that from those

associated forces the desired result, the product wanted, may follow. But, as we saw, the natural forms of matter are often so infinitely large, often so infinitely fine, that human hands are too weak or too coarse to control them. We are as powerless to overcome the cohesion of the wall of rock when we want building stone as we are, from carbon, nitrogen, hydrogen, oxygen, phosphor, potash, etc., to put together a single grain of wheat. But there are other powers which can easily do what is denied to us, and these are the powers of nature. There are natural powers which far exceed the possibilities of human power in greatness, and there are other natural powers in the microscopic world which can make combinations that put our clumsy fingers to shame. If we can succeed in making those forces our allies in the work of production, the limits of human possibility will be infinitely extended. And this we have done.

25 ·

COTTON: AN ILLUSTRATION OF UTILITIES

C. F. JONES

In the southern part of the cotton belt picking begins in July, and in the northern part about two months later. At about the time of first picking, rainfall and temperatures are decreasing. This is very desirable because too much rain during the picking season discolors the cotton. . . . Because of the irregular ripening of the cotton it is necessary to pick several times. Picking the cotton is the biggest single job of the farmer. . . . Cotton is taken directly from the field to a nearby cotton gin where the seeds are removed from the lint. For every pound of cotton lint there are two pounds of seed. . . . The cotton is baled at the gin and then taken to a nearby village and sold.

Cotton buyers in these villages are purchasing a certain quality of cotton for customers who want just that type. After purchasing the cotton, the village buyer sells by telephone to agents in central markets, ports, or cotton mills. Next day he ships to these agents who in turn resell it to the mills in the United States or export it. Often the original buyer sells directly to mills.

Transportation is by means of mule teams to the gin, and by mule team or small truck to the village where it is first sold. From there it may go by large truck or train to the central cities or ports, where it will be shipped by rail or boat to the northern manufacturing plants or by steamer to the foreign markets.

Cotton . . . is in demand universally for men's, women's, and children's clothing. It is used in tires, for paper making, for the production of celluloid, and has innumerable other uses. The seeds are used for oils, oleomargarine, and soap, while the hulls of the seed are used for fertilizer and stock feed.

26 ·

THE ADVANTAGES OF DIVISION OF LABOUR

ADAM SMITH

THIS GREAT INCREASE of the quantity of work which, in consequence of the division of labour, the same number of people are capable of performing, is owing to three different circumstances; first, to the increase of dexterity in every particular workman; secondly, to the saving of time which is commonly lost in passing from one species of work to another; and lastly, to the invention of a great number of machines which facilitate and abridge labour, and enable one man to do the work of many.

First, the improvement of the dexterity of the workman necessarily increases the quantity of work he can perform; and the division of labour, by reducing every man's business to some one simple operation, and by making this operation the sole employment of his life, necessarily increases very much the dexterity of the workman.

* * * *

Secondly, the advantage which is gained by saving the time commonly lost in passing from one sort of work to another is much greater than we should at first view be apt to imagine it. It is impossible to pass very quickly from one kind of work to another that is carried on in a different place and with quite different tools. A country weaver, who cultivates a small farm, must lose a good deal of time in passing from his loom to the field, and from the field to his loom. When the two trades can be carried on in the same workhouse, the loss of time is no doubt much less. It is even in this case, however, very considerable. A man commonly saunters a little in turning his hand from one sort of employment to another. When he first begins the new work he is seldom very keen and hearty; his mind, as they say, does not go to it, and for some time he rather trifles than applies to good purpose. The habit of sauntering and of indolent careless application, which is naturally, or rather necessarily acquired by every country workman who is obliged to change his work and his tools every half hour, and to apply his hand in twenty different ways almost every day of his life, renders him almost always slothful and lazy, and incapable of any vigorous application even on the most pressing occasions. Independent, therefore, of his deficiency in point of dexterity, this cause alone must always reduce considerably the quantity of work which he is capable of performing.

Thirdly, and lastly, everybody must be sensible how much labour is facilitated and abridged by the application of proper machinery. It is unnecessary to give any example. I shall only observe, therefore, that the invention of all those machines by which labour is so much facilitated and abridged seems to have been originally owing to the division of labour. Men are much more likely to discover easier and readier methods of attaining any object when the whole attention of their minds is directed towards that single object than when it is dissipated among a great variety of things. But in consequence of the division of labour, the whole of every man's attention comes naturally to be directed towards some one very simple object. It is naturally to be expected, therefore, that some one or other of those who are employed in each particular branch of labour should soon find out easier and

readier methods of performing their own particular work, wherever the nature of it admits of such improvement. A great part of the machines made use of in those manufactures in which labour is most subdivided, were originally the inventions of common workmen, who, being each of them employed in some very simple operation, naturally turned their thoughts towards finding out easier and readier methods of performing it. . . . In the first fire-engines, a boy was constantly employed to open and shut alternately the communication between the boiler and the cylinder, according as the piston either ascended or descended. One of those boys, who loved to play with his companions, observed that, by tying a string from the handle of the valve which opened this communication to another part of the machine, the valve would open and shut without his assistance, and leave him at liberty to divert himself with his play-fellows. One of the greatest improvements that has been made upon this machine, since it was first invented, was in this manner the discovery of a boy who wanted to save his own labour.

All the improvements in machinery, however, have by no means been the inventions of those who had occasion to use the machines. Many improvements have been made by the ingenuity of the makers of the machines, when to make them became the business of a peculiar trade; and some by that of those who are called philosophers or men of speculation, whose trade it is not to do anything, but to observe everything; and who, upon that account, are often capable of combining together the powers of the most distant and dissimilar objects. In the progress of society, philosophy or speculation becomes, like every other employment, the principal or sole trade and occupation of a particular class of citizens. Like every other employment too, it is subdivided into a great number of different branches, each of which affords occupation to a peculiar tribe or class of philosophers; and this subdivision of employment in philosophy, as well as in every other business, improves dexterity and saves time. Each individual becomes more expert in his own peculiar branch, much more work is done upon the whole, and the quantity of science is considerably increased by it.

It is the great multiplication of the productions of all the different arts, in consequence of the division of labour, which occasions, in a well-governed society, that universal opulence which extends itself to the lowest ranks of the people. Every workman has a great quantity of his own work to dispose of beyond what he himself has occasion for; and every other workman being exactly in the same situation, he is enabled to exchange a great quantity of his own goods for a great quantity, or, what comes to the same thing, for the price of a great quantity of theirs. He supplies them abundantly with what they have

occasion for, and they accommodate him as amply with what he has occasion for, and a general plenty diffuses itself through all the different ranks of the society.

Observe the accommodation of the most common artificer or day-labourer in a civilised and thriving country, and you will perceive that the number of people of whose industry a part, though but a small part, has been employed in procuring him this accommodation, exceeds all computation. The woollen coat, for example, which covers the day-labourer, as coarse and rough as it may appear, is the produce of the joint labour of a great multitude of workmen. The shepherd, the sorter of the wool, the wool-comber or carder, the dyer, the scribbler, the spinner, the weaver, the fuller, the dresser, with many others, must all join their different arts in order to complete even this homely production. How many merchants and carriers, besides, must have been employed in transporting the materials from some of those workmen to others who often live in a very distant part of the country! how much commerce and navigation in particular, how many ship-builders, sailors, sail-makers, rope-makers, must have been employed in order to bring together the different drugs made use of by the dyer, which often come from the remotest corners of the world! What a variety of labour, too, is necessary in order to produce the tools of the meanest of those workmen! To say nothing of such complicated machines as the ship of the sailor, the mill of the fuller, or even the loom of the weaver, let us consider only what a variety of labour is requisite in order to form that very simple machine, the shears with which the shepherd clips the wool. The miner, the builder of the furnace for smelting the ore, the seller of the timber, the burner of the charcoal to be made use of in the smelting-house, the brick-maker, the brick-layer, the workmen who attend the furnace, the mill-wright, the forger, the smith, must all of them join their different arts in order to produce them. Were we to examine, in the same manner, all the different parts of his dress and household furniture, the coarse linen shirt which he wears next his skin, the shoes which cover his feet, the bed which he lies on, and all the different parts which compose it, the kitchen-grate at which he prepares his victuals, the coals which he makes use of for that purpose, dug from the bowels of the earth, and brought to him perhaps by a long sea and long land carriage, all the other utensils of his kitchen, all the furniture of his table, the knives and forks, the earthen or pewter plates upon which he serves up and divides his victuals, the different hands employed in preparing his bread and his beer, the glass window which lets in the heat and the light, and keeps out the wind and the rain, with all the knowledge and art requisite for preparing that beautiful and happy invention, with-

out which these northern parts of the world could scarce have afforded a very comfortable habitation, together with the tools of all the different workmen employed in producing those different conveniences; if we examine, I say, all these things, and consider what a variety of labour is employed about each of them, we shall be sensible that, without the assistance and co-operation of many thousands, the very meanest person in a civilized country could not be provided, even according to what we very falsely imagine the easy and simple manner in which he is commonly accommodated.

* * * *

27 ·

THE ATOMIC ERA

A. ATOMIC ENERGY ENTERPRISE

T. K. GLENNAN

"How do we happen to have an atomic energy enterprise in this country at all?" The answer to this goes all the way back to 1939, when a group of foreign-born scientists—many of them refugees from the Nazi and Fascist countries of Europe—initiated an approach to President Roosevelt recommending that the federal government sponsor an atomic energy development program in the United States. These scientists were motivated by the fact that early in 1939 it had been demonstrated in a number of different laboratories throughout the world that a nuclear chain reaction could be set up and maintained in uranium with a consequent release of fabulous amounts of energy.

They suspected what this could mean militarily, and they knew what it could mean if this new source of energy were harnessed first in a military way by the enemies of the free nations of the world. So they took the leadership in bringing about the establishment of a wartime atomic energy program in this country which had as its objective the rapid development of the atomic bomb.

Such a program . . . was established. It was a big program and its wartime cost was two billion, two hundred million dollars. Except for its very earliest days, it was carried on under the direction of the Manhattan Engineer District of the U. S. Army. This program . . . achieved its basic objective. An atomic bomb was developed and proof tested and two were exploded in a successful effort to bring the war to an early and victorious conclusion.

But the Japanese surrender took something away from this wartime project that was highly important, and that was its objectives. For almost a year after the end of the war the atomic energy program of this country had no place to go. It was a program that had been designed for one purpose—to develop an atomic bomb as a means of helping to bring the war to an early and successful conclusion. This had been done. What was to be the next step? For more than six months the Congress debated this question and one result was a noble statement of purpose—the Declaration of Policy of the Atomic Energy Act of 1946.

"It is hereby declared to be the policy of the people of the United States," the preamble to this Act says, "that, subject at all times to the paramount objectives of assuring the common defense and security, the development and utilization of atomic energy shall, so far as practicable, be directed toward improving the public welfare, increasing the standard of living, strengthening free competition in private enterprise, and promoting world peace."

Here were some new and lofty objectives worthy of capturing the imagination of the best people in science and industry. To attain them, the Act created a civilian Commission of five members . . . and provided this Commission with a General Advisory Committee of top-grade scientists and industrialists to advise on scientific and technical matters, and a Military Liaison Committee to insure continued close contact with the armed forces.

* * * *

The problem here is to work toward our military goals with our peaceful goals in mind, and to do it in such a way that the knowledge, materials and skills we obtain are not wasted from the peacetime point of view. To illustrate:

One, we have a program for the acquisition of uranium ore. . . .

Two, we have a program for processing this uranium ore to degrees of extreme purity. . . .

Three, we have a program for the production from this purified uranium metal of the fissionable materials plutonium and uranium-235. . . .

Four, we have a program for the utilization of these fissionable materials in the production of atomic weapons.

Five, we have a program for the development of nuclear reactors designed to utilize fissionable materials in the production of power for useful purposes.

Six, we have a program for the production and distribution of radioisotopes produced in the Commission's nuclear reactors.

And seven, we have a program of research designed to add to our basic knowledge of nuclear forces, to make our production processes more efficient, to protect the health and safety of our workers and the population in general, and to discover an increasingly wider variety of peaceful uses for the atom. In the long-range picture this activity is second to none in importance.

B. IMPACT OF THE ATOMIC ERA

SUMMER T. PIKE

Great segments of the American people are learning things about atomic energy which will be useful in their peaceful pursuits in the future. Even in our present early stages, where industry has not had quite a fair chance to apply atomic energy to its own problems, we see developments here and there which give great promise of new applications.

In agriculture, for instance, it has been stated flatly that more has been learned about fertilizers and their application in the last three years than in the previous fifty.

Certain companies have adopted a very simple technique for measuring thickness of sheets of metal, plastic, paper, rubber and other materials which offers economies to the manufacturer and better quality to the users. Lubricating oils have been improved by a better understanding of just what a lubricating oil does in minimizing friction. Traces of radioactive elements have allowed analyses of industrial processes which previously were extremely difficult or even impossible.

In a broader field, we seem to be beginning to understand some of the reasons why the human machinery grows old with unnecessary speed, and in an area even broader than that some of our scientists

believe they are hot on the trail of understanding, and perhaps reproducing, that most fundamental of all processes, whereby the growing plant takes water and carbon dioxide in the presence of sunlight and makes the various forms of nourishment on which all forms of animal life depends.

* * * *

The application of these new facts is only beginning. In industry and agriculture, it's again impossible to predict either how or when the effects will be felt, but I should be willing to wager that by the end of another generation no one who is still here will fail to have had his life affected in a rather major fashion by the development which will flow out of exploitation of atomic energy.

* * * *

As to when or whether we shall have atomic power commercially and competitively useful for ordinary central station purposes, we have a more difficult problem. Because of our natural endowment of large amounts of cheap coal, oil and natural gas, and our continuous development and techniques of large-scale power production units, we have set a very difficult mark for any new source of power to meet.

* * * *

C. BUSINESS ASPECTS

H. D. SMYTH

As an interesting comparison, it can be said that the Atomic Energy Commission's plant assets as of June 30, 1950, exceeded in gross book value those of the General Motors Corporation and were about two thirds those of the U. S. Steel Corporation. Under the Commission's program, approximately $25,000 capital expenditure is required per employee compared to $11,000 per employee in a typical processing company such as duPont, or $4,400 per employee in a typical fabricating company such as General Motors. This high per capita outlay reflects (1) the complexity of processing atomic energy materials and (2) the high cost of protecting workers and environment from ever-present radioactivity. . . .

Our operating expenses for the fiscal year 1951 will be approximately $400,000,000. When our new plants are in operation, the Atomic Energy Commission will be the largest single user of electrical power in this country.

* * * *

D. POTENTIALITIES

H. A. WINNE

Our scientists tell us, and have proved, that matter, or mass, can be converted into energy. Actually, when we burn coal by causing it to combine with the oxygen of the air, we convert an infinitesimal part of the mass of the coal and air into energy. I say infinitesimal because if we consider the total weight of carbon and oxygen used in the burning process, we actually convert only about one eleven-billionth of the mass into energy. Not a very efficient conversion process.

We do not know—perhaps I should say, yet know—how to convert total mass to energy, but we have, within the past few years, learned to convert to energy one one-thousandth of the mass of a unique substance, a type of uranium known as Uranium 235, through the process known as chain-reacting atomic, or nuclear, fission; in other words by atom-splitting.

This conversion to energy of one one-thousandth of the mass is really a long step ahead. This is demonstrated by the fact that if we split completely a pound of Uranium-235 atoms, we release as much heat as we can get from the ordinary burning of about three million pounds of coal. . . .

28·

ANGLO-AMERICAN PRODUCTIVITY STUDIES

FRANCIS WILLIAMS

In the last twelve months fifteen teams of managers, technicians and workers from various industries have visited America to study production methods. They have brought back very valuable reports, six of which so far have been published. Each one of them has commented at length on the much higher level of productivity ruling in the American industry. And, since higher productivity is one of our

chief needs, it is argued with much force and a good deal of logic that British workers and British managements can and must learn from American methods.

So they can. So they must. And so—as the attitude of these production teams shows—they are prepared to do. And, although there are some things American industry can learn from us, the balance is not equal. Over the whole field of modern industry there is more—and probably much more—that we can learn from American techniques than American managers and workers can learn from ours.

That being said—and said without reserves of any kind—there is still a good deal to say. We can almost certainly raise output considerably in a number of industries by studying American techniques. But I think we shall be mistaken if we imagine that it is possible to raise British output per man to the same level as American output per man—or that it would be a good thing if we could.

The other week the leaders of all the fifteen productivity teams that have so far visited America wrote to *The Times* saying how valuable their experience had been and very sensibly urging other industries to go and learn likewise. "We have," they went on, "learned lessons not confined to techniques of productive processes. . . . We have been face to face with an enthusiasm in applying knowledge, an outlook on industrial productivity and a way of life which constitute a challenge to the whole world." It is with this challenge and its relationship to what we can learn from America that I want to deal.

American productivity has been brought to the highest level in the world by a combination of a number of things, among them techniques of management, machine utilisation, industrial lay-out, management-worker relations within the plant and the use of a great deal of unskilled auxiliary labour by breakdown of elaborate processes into simple parts. It is a pattern which has been adapted not only to industrial production but to distribution and even to some of the professions.

Some of these techniques can be transplanted here with great advantage. But that does not mean that the whole pattern of American production method—successful though it is in an American context—is capable of being transplanted here or that it would be a good thing if it were. It cannot be transplanted, just because it is, in fact, a part of that American way of life to which the leaders of the productivity teams point as part of the United States challenge to the world. The American industrial system is what it is because of the social framework within which it operates.

The British manager and British worker can no doubt learn a good deal from the American manager and the American worker. But they

cannot become American managers and American workers—and it would be a bad thing if they tried to. Nor can the British consumer become an American consumer. This is the conditioning factor we should be wise to keep in mind when we consider what we can learn from American methods.

The really distinguishing features of American industrial technique are a result of American history. They were designed in the first place to overcome a specific American problem and answer a specific American need. And, like all successful industrial processes, they have helped to form the characters of those who operate them and those who buy from them.

They were shaped by two things. The first was the American need to absorb and make fully productive very large numbers of unskilled immigrant workers. These workers could only be fitted quickly into an industrial system if a way could be found to break down highly skilled and highly involved technical processes into a great many routine parts, each one of which could be carried out by men with a minimum of training and experience: men, moreover, who had no desire to settle down and learn one particular skill but who by the nature of their society were just as likely to move on to a quite different industry in a few years or even months if the pay packet seemed likely to be larger.

"Much British work is too highly finished," says one of the Productivity Reports, and remarks that some members of the team were appalled at the condition of some of the connecting rods turned out by an American plant for motor-cars. "But," it comments, "they served their purpose."

That is an adequate answer in a system where the worker is thought of, and thinks of himself, primarily as a unit in a production technique designed by an efficiency engineer—where he finds his satisfaction in figures of total output. It is not likely to be so adequate in a more individualistic society like ours, where a worker feels himself not just a unit but a person, where he wants to be able to look at the bit he has done himself and say with a certain pride: "I reckon that's none so bad anyway."

Although production systems are shaped by the needs and expectations of their societies, productivity depends not only on systems but on the men who operate them—workers and managers. "There was an air of the competitive system wherever the team went," says one of the productivity reports. And another, "Every employee from president to operator is production-minded." And it is certainly true that, in the words of a recent survey of American labour organisation by an Amer-

ican trade union official, Mr. Sidney Lens, "American labour is the most business-conscious labour movement in the world."

But before deciding what we in Britain can, and cannot, learn from this, let us look a little closer into its meaning. It does not mean that relations between labour and management as a whole are better in the United States than they are here. Indeed the contrary is the case.

Industry-wide stoppages resulting from irreconcilable differences between trade unions and managements have to all practical purposes disappeared from the British industrial scene. Except for occasional unofficial strikes, negotiation and arbitration have taken the place of the strike weapon. Not so in America. There the industry-wide strike—like those of last year in steel and coal which threatened to bring the whole economic life of the nation to a standstill—is still a characteristic feature of the industrial landscape.

American workers and American managements do not always like each other—but they like the same things. They speak the same language in the workshop, because it is a specifically American language. It is the language of a country which to a degree not paralleled anywhere else has accepted earning power as one of the chief tests by which a man's value as a social being and an individual is judged—and not only by others but by himself. Now that is clearly a great gain to an industrial system, although it may bring its problems for a civilisation.

When I was in the States for the last time a few months ago there was cabled over from England by a visiting American correspondent a story that shocked America. It was the story of a miner who was asked why he worked a certain number of shifts. "Well," said he, "If I worked less it 'ud be a bit tight for the missus and me and if I worked more I wouldn't have time to look to my garden." "That," said the American correspondent, "is why British productivity is low. British workers prefer to grow roses."

And so, within reason, they do. At the present time it is obviously necessary that we should all curtail our liking for such pleasant occupations and concentrate on increasing the output of the things by which we live. And in doing so we can certainly learn a great deal from some American methods of manufacture and distribution. But let us not, in our proper desire to learn, imagine that we can transplant American industrial methods or American industrial attitudes in their entirety. Or that it would be a good thing if we could.

29 · U. S. COTTON SPINNING: A BRITISH VIEW

THE REASONS GIVEN by visiting Englishmen for the high productivity of American mills are as follows:

The productivity-mindedness of management, supervisory staff and operatives. Textile unions support the policy.

Willingness of managements and operatives to give a fair trial to new machines and new methods rather than to rely on experiments by others.

Widespread use of standards against which the performances of men, machines, and raw material can be measured at every stage of manufacture, thus ensuring prompt detection of faults.

Good relations between management and labour. There is provision for two-way channels of information from top to bottom and bottom to top, and for publicity at mill level, but little joint consultation in works councils or production committees.

Acceptance by operatives and unions of the principle that work assignments should be based on a fair work load and not on an arbitrary number of machines or spindles tended.

Recognition that the work assignment should be changed with the introduction of new machinery, methods or working conditions; the work load should remain constant, not the number of machines or spindles attended.

Good provision for technological training of all grades and thorough on-the-job training for new operatives.

Good timekeeping.

Adequate supplies of labour.

Use of good costing systems which are on more standardized lines than in England.

Simplification by the limitation of the yarn counts spun.

Three-shift working, making it easier to justify expenditure on new machinery and labour-saving devices.

Allocation of considerable sums from profits for the purchase of machinery

Use of the pick of American raw cotton ensuring great regularity of grade, staple, character and continuity of supply. At the present date spinners in England have to pay a higher premium than spinners in the United States for the types which are desired by mills using short processing, and sometimes these types are unobtainable.

Thorough blending with the use of a range of hopper blenders and a large number of bales in the mixing.

Almost invariable use of single process opening.

Use of packages bigger than in English mills at each process throughout the card room.

A tendency for comber rates of production to be higher than in England, particularly with the latest types of machines.

Use of only two passages of draw frames, and occasionally one passage, with or without a lap former.

The practically invariable adoption of shortened processing on speed frames.

Use of ring frames on which packages are produced holding 91 per cent. more weight on the average than those in English mills.

Low end-breakage rates, averaging 2.4 per 100 spindles per hour on speed frames and 3.2 per 100 spindles per hour on ring frames, due to the use of first class raw materials, proper blending, good machine maintenance, constant temperature, regular and correct relative humidity, and good carding. The carding rate of production is considerably less than is normal in English mills.

Use wherever possible of mechanical aids and labour-saving devices.

30 ·

THE POPULATION THEORY

THOMAS ROBERT MALTHUS

In an inquiry concerning the improvement of society, the mode of conducting the subject which naturally presents itself, is,

1. To investigate the causes that have hitherto impeded the progress of mankind towards happiness; and,

2. To examine the probability of the total or partial removal of these causes in future (*sic*).

To enter fully into this question, and to enumerate all the causes that have hitherto influenced human improvement, would be much beyond the power of an individual. The principal object of the present essay is to examine the effects of one great cause intimately united with the very nature of man; which, though it has been constantly and powerfully operating since the commencement of society, has been little noticed by the writers who have treated this subject. The facts which establish the existence of this cause have, indeed, been repeatedly stated and acknowledged; but its natural and necessary effects have been almost totally overlooked; though probably among these effects may be reckoned a very considerable portion of that vice and misery, and of that unequal distribution of the bounties of nature, which it has been the unceasing object of the enlightened philanthropist in all ages to correct.

The cause to which I allude is the constant tendency in all animated life to increase beyond the nourishment prepared for it.

It is observed by Dr. Franklin that there is no bound to the prolific nature of plants or animals but what is made by their crowding and interfering with each other's means of subsistence. Were the face of the earth, he says, vacant of other plants, it might be gradually sowed

and overspread with one kind only, as for instance with fennel: and were it empty of other inhabitants, it might in a few ages be replenished from one nation only, as for instance with Englishmen.

This is incontrovertibly true. Through the animal and vegetable kingdoms Nature has scattered the seeds of life abroad with the most profuse and liberal hand; but has been comparatively sparing in the room and the nourishment necessary to rear them. The germs of existence contained in this earth, if they could freely develop themselves, would fill millions of worlds in the course of a few thousand years. Necessity, that imperious, all-pervading law of nature, restrains them within the prescribed bounds. The race of plants and the race of animals shrink under this great restrictive law; and man cannot by any efforts of reason escape from it.

In plants and irrational animals, the view of the subject is simple. They are all impelled by a powerful instinct to the increase of their species; and this instinct is interrupted by no doubts about providing for their offspring. Wherever therefore there is liberty, the power of increase is exerted; and the super-abundant effects are repressed afterwards by want of room and nourishment.

The effects of this check on man are more complicated. Impelled to the increase of his species by an equally powerful instinct, reason interrupts his career, and asks him whether he may not bring beings into the world for whom he cannot provide the means of support. If he attend to this natural suggestion, the restriction too frequently produces vice. If he hear it not, the human race will be constantly endeavouring to increase beyond the means of subsistence. But as, by that law of our nature which makes food necessary to the life of man, population can never actually increase beyond the lowest nourishment capable of supporting it, a strong check on population, from the difficulty of acquiring food, must be constantly in operation. This difficulty must fall somewhere, and must necessarily be severely felt in some or other of the various forms of misery, or the fear of misery, by a large portion of mankind.

* * * *

It may safely be pronounced . . . that population, when unchecked, goes on doubling itself every twenty-five years, or increases in a geometrical ratio.

The rate according to which the productions of the earth may be supposed to increase, it will not be so easy to determine. Of this, however, we may be perfectly certain, that the ratio of their increase in a limited territory must be of a totally different nature from the ratio

of the increase of population. A thousand millions are just as easily doubled every twenty-five years by the power of population as a thousand. But the food to support the increase from the greater number will by no means be obtained with the same facility. Man is necessarily confined in room. When acre has been added to acre till all the fertile land is occupied, the yearly increase of food must depend upon the melioration of the land already in possession. This is a fund, which, from the nature of all soils, instead of increasing, must be gradually diminishing. But population, could it be supplied with food, would go on with unexhausted vigour; and the increase of one period would furnish the power of a greater increase the next, and this without any limit.

* * * *

If this supposition be applied to the whole earth, and if it be allowed that the subsistence for man which the earth affords might be increased every twenty-five years by a quantity equal to what it at present produces, this will be supposing a rate of increase much greater than we can imagine that any possible exertions of mankind could make it.

It may be fairly pronounced, therefore, that, considering the present average state of the earth, the means of subsistence, under circumstances the most favourable to human industry, could not possibly be made to increase faster than in an arithmetical ratio.

The necessary effects of these two different rates of increase, when brought together, will be very striking. Let us call the population of this island eleven millions; and suppose the present produce equal to the easy support of such a number. In the first twenty-five years the population would be twenty-two millions, and food being also doubled, the means of subsistence would be equal to this increase. In the next twenty-five years, the population would be forty-four millions, and the means of subsistence only equal to the support of thirty-three millions. In the next period the population would be eighty-eight millions, and the means of subsistence just equal to the support of half that number. And, at the conclusion of the first century, the population would be a hundred and seventy-six millions, and the means of subsistence only equal to the support of fifty-five millions, leaving a population of a hundred and twenty-one millions totally unprovided for.

Taking the whole earth, instead of this island, emigration would of course be excluded; and, supposing the present population equal to a thousand millions, the human species would increase as the numbers, 1, 2, 4, 8, 16, 32, 64, 128, 256, and subsistence as 1, 2, 3, 4, 5, 6, 7, 8, 9.

In two centuries the population would be to the means of subsistence as 256 to 9; in three centuries as 4096 to 13, and in two thousand years the difference would be almost incalculable.

In this supposition no limits whatever are placed to the produce of the earth. It may increase for ever and be greater than any assignable quantity; yet still the power of population being in every period so much superior, the increase of the human species can only be kept down to the level of the means of subsistence by the constant operation of the strong law of necessity, acting as a check upon the greater power. We will suppose the means of subsistence in any country just equal to the easy support of its inhabitants. The constant effort towards population, which is found to act even in the most vicious societies, increases the number of people before the means of subsistence are increased. The food, therefore, which before supported eleven millions, must now be divided among eleven millions and a half. The poor consequently must live much worse, and many of them be reduced to severe distress. The number of labourers also being above the proportion of work in the market, the price of labour must tend to fall, while the price of provisions would at the same time tend to rise. The labourer therefore must do more work to earn the same as he did before. During this season of distress, the discouragements to marriage and the difficulty of rearing a family are so great that the progress of population is retarded. In the meantime, the cheapness of labour, the plenty of labourers, and the necessity of an increased industry among them, encourage cultivators to employ more labour upon their land, to turn up fresh soil, and to manure and improve more completely what is already in tillage, till ultimately the means of subsistence may become in the same proportion to the population as the period from which we set out. The situation of the labourer being then again tolerably comfortable, the restraints to population are in some degree loosened; and, after a short period, the same retrograde and progressive movements, with respect to happiness, are repeated.

31 ·

SHIFTS IN THE POPULATION

R. J. COLBERT

EVERY CITIZEN HAS A ROLE in the maintenance of the progress of his community. Being a free person, however, it is certain that he is not bound to support inefficiencies, incompetence, or obsolescence, and he is most certain to be sensitive about his opportunities for employment and economic outlook; he is sure to go where he can get the most for his money, the best service possible, and the best job possible.

Traditionally the American population has always been characterized by a high degree of mobility. This has always been a problem for stable community development. *But never before has there been an internal population movement of such magnitude as has taken place in the last few years*—between 1940 to 1947 some 44 million persons changed houses within the same county; 13 million had gone from one county to another in the same state; 12 million had changed their residence to another state! The farm population was the greatest loser in this migration. It was estimated that 3.2 million left the farms. The Far West Pacific coast states attracted 94.2 per cent of the migration, and as a result, the region gained 4 million, or 40.9 per cent in population. Nine states in the South, Central North, and Northwest find they have a smaller population now than they had in 1940. In all, 28 states experienced a *net loss* through migration; 20 states and the District of Columbia had a combined *net gain* of 5.6 million. The largest gain for a single state was that of California—42.1 per cent, compared with the gain for the United States as a whole of 8.9 per cent.

More than 60 per cent of those who migrated admitted that they left their former community in order to improve job opportunity. The newly established and expanded manufacturing industries of California and the Pacific states served as a lodestone, attracting millions of workers, especially young people from other states.

This landslide of population shift has made many communities strongly conscious of the job opportunity which can be provided by an adequate development of manufacturing industry. It undoubtedly is also a major contributing factor in the widespread popular interest being taken in small plants. It is, in short, a recognition of the importance of the small plant to the present and future progress of the community.

We may conclude, therefore, that community progress rests mainly with the various business and service leaders, and more especially does it rest heavily upon the shoulders of the local manufacturers.

32 ·

LABOR MOBILITY

LLOYD G. REYNOLDS

THERE ARE AT LEAST EIGHT external obstacles to free movement of workers among employers.

1. A worker can move to another plant only when a vacancy exists in that plant. This means that opportunities for movement occur mainly toward the peaks of business cycles and are much reduced at other times.

2. The extreme occupational specialization of modern industry means that many jobs in a plant may have no counterpart elsewhere in the area. In this event, the worker cannot change employers without changing his occupation

3. Partly because of this occupational specialization, many employers fill a large proportion of their vacancies by promotion from within the present labor force. In manufacturing plants, one frequently finds that hiring from the outside is confined mainly to skilled maintenance

jobs and to unskilled labor, i.e., to jobs which are interchangeable among different plants. Semiskilled production jobs may be filled entirely through promotion and may never come into the outside market.

4. When employers do hire from the outside, their selection of workers is guided by an elaborate system of hiring requirements and preferences. Workers are far from being interchangeable in the employer's eyes. He is likely to give first preference to previous employees of the company whose past performance was satisfactory. Next will come people recommended by present employees of the company; having friends already in the plant usually gives one an inside track in hiring. Next will come unemployed workers, provided they have not been unemployed too long. The man who has been unemployed for a long time will have less chance of employment than anyone else, because employers tend to take long periods of unemployment as an indication that the man is not worth hiring.

5. In addition to these general preferences, employers usually have more specific hiring requirements for particular jobs. These requirements run in terms of age, sex, color, national origin, education, experience, physical qualifications, character, personality traits, and so on. Because of these numerous screening factors, only a few of the thousands of workers in an area may actually be eligible for a particular job.

6. A serious obstacle to movement, particularly in small towns and cities, is the existence of a tacit understanding among employers that they will not hire away one another's workers. These understandings, often referred to as "antipirating agreements," operate in the following way. An applicant for work at Plant A is asked what he is doing now, and replies that he is currently employed at Plant B but wants to move. The employment manager of Plant A then calls up the employment manager of Plant B and asks him whether his company is willing to release the worker in question. If the employment manager of Plant B says that his company still needs the worker and does not wish him to leave, Plant A will usually refuse to employ him. Where this practice exists, a worker is almost forced to cut his ties with his present employer before seeking a new one. This necessity increases the risk of movement and makes more workers unwilling to take the risk.

7. It is difficult for workers to learn about wages, conditions, and job openings in other plants. There are certain exceptions, such as printing and building construction, where the union serves as a channel of information and even as a placement agency. In most industries, however, there is no place in the area where one can find a complete

listing of vacancies with the wages and terms of employment relating to each. The nearest thing to such a listing is the file of employer orders at the local office of the state employment service. Employers are under no compulsion to list jobs at the state employment service, however, and usually do so only if they have not been able to fill the job from direct application at the plant. There is thus a tendency for the worst jobs to be listed at the employment service; the better jobs are filled by people who have heard about them "on the grapevine" or who just happened to walk into the personnel office at the right moment.

Even when a worker has located a job, he cannot learn much about it until he has worked on it. He can learn in advance the general nature of the tasks and the starting wage rate, but he cannot learn how the foreman will treat him, how he will get along with the gang, how rapidly he will be able to secure merit wage increases and promotions, and many other things. The fact that some of the most important things about a job cannot be learned from the outside makes "window-shopping" for jobs difficult and hazardous.

8. Another obstacle to mobility is the fact that additional years of service in a company usually bring the worker rights and perquisites which attach him more firmly to the company. Seniority protection is the most obvious of these, but there are many others. The long-service worker may be eligible for longer vacation periods; he may have life insurance and pension rights which would be lost by leaving the company; he may have worked some distance up the occupational ladder in the plant and might have to start over again at the bottom if he moved. These things make a worker think several times before leaving his present job.

Let us turn now to the subjective aspect of labor mobility—the motives and attitudes of the workers themselves. Within the limitations just indicated, do they react to alternate job opportunities in an economic way? The answer is both yes and no. If an unemployed worker has before him two or more job opportunities, which offer different wage rates but are reasonably comparable in other respects, he can usually be counted on to choose the higher-paying job. To this extent, worker behavior is economic. The crux of the matter, however, is that workers are rarely in a position to make the kind of choice just described. The reasons for this deserve brief examination.

Most workers in an area at any time have a job, and most of them are satisfied with the jobs they have. . . . If the whole constellation of job conditions is satisfactory, the worker is not likely to become

concerned over his wage rate or to be interested in new job opportunities. He takes it for granted that he will continue on where he is. If it comes to his attention that higher wages are being earned elsewhere, he will probably find some good reason why his own job is better anyway, or why it would not be practical for him to move. The bulk of the workers in an area, then, are not in the labor market in any realistic sense. It does not occur to them that they should keep their eyes constantly roving around the area for the best job available. If they have a "good job," the fact that there may be a "best job" somewhere else in the area is of little practical importance.

Workers are coming into the market all the time, however, from a variety of sources—workers who have been laid off or discharged, dissatisfied workers who have quit their jobs voluntarily, people who have moved from other areas, and young people beginning work for the first time. If these people chose jobs in an economic way, the immobility of the others might not matter. Even the people who need jobs, however, do not go about finding them in a very systematic way. The commonest method is to get in touch with former employers, relatives, friends, or even casual acquaintances, in the hope of hearing about a job and getting some inside help in securing it. The next commonest method is to drop into the employment office of a plant which is near the worker's home, or which is in his usual line of industry, or which is large and well known in the area. The worker usually takes the first job which meets his minimum standards of acceptability, and very often the first job which he hears about. Few workers take the trouble to shop around for a number of jobs and then select the most promising.

33

HOURS OF WORK IN 1495

AND FERTHERMORE where divers artificers and laborers reteyned to werke and serve waste moch part of the day and deserve not their wagis, summe tyme in late commyng unto their werke, erly departing therfro, longe sitting at ther brekfast at ther dyner and nonemete, and long tyme of sleping at after none, to the losse and hurte of such persones as the seid artificers and laborers be reteyned with in service; It is therfor establisshed enacted and ordyned by auctorite aforeseid that every artificer and laborer be at his werke, betwen the myddes of the moneth of March and the myddes of the moneth of September, before V of the Clocke in the mornying, And that he have but half an houre for his brekefast, and an houre and an half for his dyner at such tyme as he hath season for slepe to hym appoynted by this estatute, and at such tyme as is herin appoynted that he shall not slepe then he to have but an houre for his dyner and half an houre for his nonemete; and that he departe not from his werke, betwene the myddes of the seid monethes of March and September, till betwene vij and viij of the clocke in the evenyng; And if they or any of theym offende in any of theis articles that then their defautes be marked by hym or his Deputie that shall pay their wages, and atte wokes end ther wages to be abated for such rate of tyme as they have offended contrarie to this estatute: And that fro the myddes of September to the myddes of Marche every artificer and laborer by at ther werke in the springing of the day and departe not till nyght of the same day: And that the seid artificers and laborers slepe not by day but only from the myddes of the moneth of May unto the myddell of the moneth of August.

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THE CONSTITUTION OF THE CIO

PREAMBLE: The Congress of Industrial Organizations grew out of the needs of the unorganized workers of America which could be met most effectively by the industrial form of organization. Since its formation in 1935, the CIO has grown strong because the service it has given to American workers has made ours a better America. We of the CIO are the sons and daughters of ancestors who came to America to escape absolutism in government, bigotry in religion, and economic exploitation. We of the CIO are proud of this American quest for liberty and the struggle for equality. We seek, today, to implement this great heritage. We are dedicated to the responsibility for furthering economic opportunity, religious freedom, and political participation.

Democracy stems entirely from free choice. Diligently practiced, it is the only logical human formula for the attainment of economic and political independence; for the realization of a just and equitable return on one's labor; for guarantees of full employment, of social security, and of the protection of the family as an institution.

In the achievement of this task we turn to the people because we have faith in them; and we oppose all those who would violate this American emphasis of respect for human dignity, all those who would use power to exploit the people in the interest of alien loyalties.

The struggle for human freedom is a continuous one. The task of those who would bring security and greater understanding to mankind throughout the world is endless. It is in this all-consuming struggle, however, that men and organizations make their contributions to a better life. Therefore, we in the CIO glory in our heritage and in the hope of our future. Racial persecution, intolerance, selfishness, and

greed have no place in the human family. We will not be satisfied until ours is a world of free men and women and of happy children. It's to these ends that this Constitution of the CIO is dedicated. It is the charter of our lives; through it we seek to maintain and extend liberty and opportunity here and throughout the world.

* * * *

Article II of the Constitution. Objects.

The objects of the organization are:

First. To bring about the effective organization of the working men and women of America regardless of race, creed, color or nationality, and to unite them for common action into labor unions for their mutual aid and protection.

Second. To extend the benefits of collective bargaining and to secure for the workers means to establish peaceful relations with their employers, by forming labor unions capable of dealing with modern aggregates of industry and finance.

Third. To maintain determined adherence to obligations and responsibilities under collective bargaining and wage agreements.

Fourth. To secure legislation safeguarding the economic security and social welfare of the workers of America, to protect and extend our democratic institutions and civil rights and liberties, and thus to perpetuate the cherished traditions of our democracy.

* * * *

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THE CONSTITUTION OF THE INTERNATIONAL UNION, UNITED MINE WORKERS OF AMERICA

PREAMBLE: There is no truth more obvious than that without coal there could not have been such marvelous social and industrial progress as marks present-day civilization.

Believing that those whose lot it is to toil within the earth's recesses surrounded by peculiar dangers and deprived of sunlight and pure air, producing the commodity which makes possible the world's progress, are entitled to protection and an equitable share of the fruits of their labor, we have formed the "United Mine Workers of America" for the purpose of establishing, by lawful means, the principles embraced in the body of this Constitution.

Article I. Name.

This Organization shall be known as the United Mine Workers of America. It shall be International in scope, and as an organization shall not be committed to favor any religious creed; neither shall affiliation herewith interfere with the religious or political freedom of individual members.

Article II. Objects.

First. To unite in one organization, regardless of creed, color or nationality, all workers eligible for membership, employed in and around coal mines, coal washeries, coal processing plants, coke ovens, and in such other industries as may be designated and approved by the International Executive Board, on the American continent.

Second. To increase the wages, and improve the conditions of employment of our members by legislation, conciliation, joint agreements or strikes.

Third. To demand that not more than six hours from bank to bank in each twenty-four hours and not more than five days per week shall be worked by members of our organization.

Fourth. To strive for a minimum wage scale for all members of our union.

Fifth. To provide for the education of our children by lawfully prohibiting their employment until they have at least reached eighteen years of age.

Sixth. To secure equitable statutory old-age pensions, workmen's compensation and unemployment insurance laws. To provide for security against old age and disability of members and their dependents.

Seventh. To enforce existing just laws and to secure the repeal of those which are unjust.

Eighth. To secure by legislative enactment, laws protecting the limbs, lives and health of our members; establishing our right to organize; prohibiting the use of deception to secure strike breakers; preventing the employment of privately armed guards during labor disputes; and such other legislation as will be beneficial to the members of our craft.

* * * *

Article X. Officers' Salaries.

Section 1. The salary of the President shall be $50,000 per annum; Vice President, $40,000 per annum; Secretary-Treasurer, $40,000 per annum; International Executive Board Members, $1,000 per month; Tellers and Auditors, $25.00 per day when employed. Each of the above mentioned officers shall receive, in addition to their salaries, such additional sums for additional service rendered as may be authorized and approved by the President; together with all legitimate expenses when employed by the Organization away from their place of residence.

* * * *

36 · GENERAL MOTORS PARTS DIVISION—UAW-CIO AGREEMENT

INTRODUCTION: The Management of General Motors Parts Division of the General Motors Corporation recognizes that it cannot get along without labor any more than labor can get along without the Management. Both are in the same business and the success of that business is vital to all concerned. This requires that both Management and the employes work together to the end that the quality and cost of the product will prove increasingly attractive to the public so that the business will be continuously successful.

General Motors Parts Division of the General Motors Corporation hold that the basic interests of employers and employes are the same. However, at times employes and the Management have different ideas on various matters affecting their relationship. The Management is convinced that there is no reason why these differences cannot be peacefully and satisfactorily adjusted by sincere and patient effort on both sides.

* * * *

RECOGNITION: (1) The Company recognizes the International Union, United Automobile, Aircraft and Agricultural Implement Workers of America, affiliated with the Congress of Industrial Organizations, as the exclusive representative of all Parts Stock Department employes of the Warehouses of the General Motors Parts Division of the General Motors Corporation at Cleveland, Ohio. . . . [Here follows a list of cities where warehouses are located.]

* * * *

CHECK-OFF OF UNION MEMBERSHIP DUES: (3) During the

life of this Agreement, the Company agrees to deduct Union membership dues levied by the International Union or local Union . . . from the pay of each employe who executes or has executed the . . . "Authorization for Check-Off of Dues" form.

* * * *

(4) The purpose of this Agreement is to provide orderly collective bargaining relations between the Company and the Union, to secure a prompt and fair disposition of grievances, to eliminate interruptions of work or interferences with the efficient operation of the business of the Company, which is recognized as being engaged in a business of service nature to dealers and customers.

(5) The Company will not interfere with, restrain or coerce employes because of membership or non-membership or lawful activities in the Union; nor will it by discrimination in respect to hiring, tenure of employment, or by any term or condition of employment attempt to discourage membership or non-membership in the Union.

(6) The Union agrees that neither the Union nor its members will intimidate or coerce any employe in respect to Union activity or membership, and further, that there shall be no solicitation of employes for Union membership or dues on Company time. The Union further agrees that the Company may take disciplinary action for any violation of this provision.

(7) The right to hire, promote, discharge or discipline for cause; and to maintain discipline and efficiency of employes is the sole responsibility of the Company, except that Union members shall not be discriminated against as such. . . . The Management may discipline any employe who fails to comply with "Safety Instructions" and "Warehouse Rules and Regulations" issued by General Motors Parts Division, General Motors Corporation, which are posted in the Warehouse.

(8) The Union shall be represented in the Parts Stock Department by a Committee of two (2) Parts Stock Department employes.

* * * *

GRIEVANCE PROCEDURE: (22) Any employe having a grievance, or one designated member of a group having a grievance, should first take the grievance up with his Supervisor or Foreman, who will attempt to adjust it.

* * * *

(24) If the grievance is not adjusted by the Supervisor or Foreman, it shall be reduced to writing on forms provided by the Company,

and signed by the employe involved and one copy shall be given to the Supervisor or Foreman. The Committeeman may then take the grievance up with higher supervision.

(25) If the case is not adjusted with higher supervision, it may be referred to the entire Committee. The Committee may then discuss the case with Management at the next scheduled bi-weekly meeting.

* * * *

(28) If the grievance is not adjusted at this step and the Committee believes it has grounds for appeal from the local Management's decision, the Chairman of the Committee will give the local Warehouse Management a written "Notice of Unadjusted Grievance" on forms supplied by the Company, and the Chairman . . . will then prepare a complete "Statement of Unadjusted Grievance," setting forth all the facts and circumstances surrounding the grievances. . . . The Warehouse Manager . . . will also prepare a complete "Statement of Unadjusted Grievance" and the Management's reason in support of the position taken. . . .

(29) The Chairman of the Committee shall then forward copies of the "Statement of Unadjusted Grievance" to the Regional Director of the International Union. The Regional Director will review the case and determine if an appeal shall be made. If he shall decide to appeal the case, he shall give notice on the form "Notice of Appeal" supplied by the Company, sending one copy to the local Warehouse Management, the Chairman of the Committee, and the General Manager of the General Motors Parts Division of the General Motors Corporation in Detroit. . . .

(30) The case will then be considered at Detroit or elsewhere as mutually agreed by an Appeal Committee consisting of four (4) members as follows: For the Union, the Regional Director, or one specified representative of the Regional Director . . . and the Chairman, or another designated member of the Warehouse involved; and for the Company, representatives of the Management.

* * * *

(33) If an adjustment of the case is not reached at this meeting, the Management will furnish a copy of its decision in writing and a copy of a summary of the minutes of the meeting to the Chairman of the Committee and the Regional Director within five (5) working days after the meeting, unless this period is extended by mutual agreement in writing.

(34) In the event of failure to adjust the case at this point, it may be appealed to an impartial Umpire, selected by mutual agreement between the parties, providing it is the type of case on which the Umpire is authorized to rule.

* * * *

(35) The impartial Umpire shall have only the functions set forth herein. The fees and expenses of the Umpire will be paid one-half by the Company and one-half by the Union and all other expenses shall be borne by the party incurring them.

* * * *

(37) It shall be the function of the Umpire after due investigation and within thirty days after submission of the case to him, to make a decision in all claims of discrimination for Union activity or membership and in all cases of alleged violation of the terms of . . . sections of this Agreement . . . and of any alleged violations of written local or national wage agreements. The Umpire shall have no power to add to or subtract from or modify any of the terms of this Agreement or any agreements made supplementary hereto; nor to establish or change any wages; nor to rule on any dispute . . . regarding Work Standards. The Umpire shall have no power to rule on any issue or dispute arising under the Pension Plan and Insurance Program Section or the Waiver Section. Any case appealed to the Umpire on which he has no power to rule, shall be referred back to the parties without decision.

(38) The Company delegates to the Umpire full discretion in cases of discipline for violation of shop rules, or discipline for violation of the Strikes, Stoppages, and Lockouts Section of the Agreement.

* * * *

(43) After a case on which the Umpire is empowered to rule hereunder has been referred to him, it may not be withdrawn by either party except by mutual consent.

(44) There shall be no appeal from the Umpire's decision, which will be final and binding on the Union and its members, the employe or employes involved and the Company. The Union will discourage any attempt of its members, and will not encourage or cooperate with any of its members, in any appeal to any Court or Labor Board from a decision of the Umpire.

* * * *

(47) Employes shall be regarded as temporary employes until their names have been placed on the seniority list. There shall be no responsibility for the reemployment of temporary employes if they are laid off or discharged during this period.

(48) Employes may acquire seniority by working ninety days during a period of six continuous months in which event the employe's seniority will date back ninety days from the date seniority is acquired. . . .

* * * *

(64) Any employe who has been disciplined by a layoff or a discharge may request the presence of the committeeman for his Section to discuss the case with him in an office designated by the local Management before he is required to leave the Warehouse. . . .

* * * *

(66) Work standards shall be established on the basis of fairness and equality, consistent with the quality of workmanship, efficiency of operations, and the reasonable working capacities of normal operators. The local Management of each Warehouse has full authority to settle such matters.

* * * *

(68) Any employe called to work or permitted to come to work without having been properly notified that there will be no work, shall receive a minimum of four hours' pay at the regular hourly rate, except in case of labor disputes, or other conditions beyond the control of the local Management.

(69) For the purpose of computing overtime premium pay, the regular working week is forty hours. . . .

Employes will be compensated as follows:

STRAIGHT TIME: (70) (a) For the first eight hours worked in any continuous twenty-four hour period, beginning with the starting time of the employe's shift. . . .

TIME AND ONE-HALF: (71) (a) For the time worked in excess of eight hours in any continuous twenty-four hours, beginning with the starting time of the employe's shift, except if such time is worked on a Sunday or holiday when double time will be paid. . . .

* * * *

DOUBLE TIME: (72) For time worked during the regular working hours of any shift that starts on Sundays, and the following legal

holidays: New Year's Day, Fourth of July, Labor Day, Thanksgiving, Christmas, and either Memorial Day or one such holiday of greater importance which must be designated in advance by mutual agreement locally in writing, and any time worked in excess of eight hours on a shift which starts the previous day and runs over into such Sunday or holiday.

* * * *

(74) A night shift premium of five per cent of night shift earnings, including overtime premium, will be paid to all hourly-rated employes half or more of the working hours of which are scheduled between the hours of 6:00 p. m. and 6:00 a. m. except that in the case of three shift operations, employes working on third shifts regularly scheduled to start between the hours of 10:00 p. m. and 4:45 a. m. will receive a night shift premium of seven and one-half per cent of night shift earnings, including overtime, for all hours worked. . . .

* * * *

(78) The establishment of wage scales for each position occupation is necessarily a matter of negotiation and agreement between the Management of the General Motors Parts Division of the General Motors Corporation and the Union on the basis of local circumstances affecting each occupation, giving consideration to the relevant factors of experience and qualifications required for proper handling of the work of each such position, continuity of employment, opportunities for further advancement, and the wage paid by other concerns in the community engaged in a similar type of business for work of a similar nature.

* * * *

(81) (a) The annual improvement factor provided herein recognizes that a continuing improvement in the standard of living of employes depends upon technological progress, better tools, methods, processes and equipment, and a cooperative attitude on the part of all parties in such progress. It further recognizes the principle that to produce more with the same amount of human effort is a sound economic and social objective. Accordingly, all employes covered by this agreement shall receive an increase of 4 cents per hour, effective May 29, 1950, and an additional increase of 4 cents per hour annually on May 29, 1951, May 29, 1952, May 29, 1953 and May 29, 1954, which will be added to the base rate of each wage classification.

(b) In addition, the cost-of-living allowance formula . . . will be continued. . . . It is agreed that only the cost-of-living allowance will be subject to reduction so that, if a sufficient decline in the cost of living occurs, employes will immediately enjoy a better standard of living. . . .

*   *   *   *

(e) The Cost-of-Living Allowance will be determined in accordance with changes in the "Consumers' Price Index for Moderate Income Families in Large Cities—All Items," published by the Bureau of Labor Statistics, U. S. Department of Labor (1935-1939=100), and hereafter referred to as the BLS Consumers' Price Index.

*   *   *   *

(82) Wage rates for women shall be set in accordance with the principle of equal pay for comparable quantity and quality of work on comparable operations.

*   *   *   *

(96) It is the intent of the parties to this Agreement that the procedures herein shall serve as a means for peaceable settlement of all disputes that may arise between them.

(97) During the life of this Agreement, the Company will not lockout any employes until all the bargaining procedures as outlined in this Agreement has (*sic*) been exhausted without a settlement and in no case on which the Umpire shall have ruled and in no case on which the Umpire is not empowered to rule until after negotiations have continued for at least five (5) days at the third step of the Grievance Procedure. In case a lockout shall occur, the Union has the option of cancelling the Agreement at any time between the tenth day after the lockout occurs and the date of its settlement.

(98) During the life of this Agreement, the Union will not cause or permit its members to cause, nor will any member of the Union take part in any sit-down, stay-in or slowdown, in any plant of the Company, or any curtailment of work or restriction of production or interference with production of the Company. The Union will not cause or permit its members to cause nor will any member of the Union take part in any strike or stoppage of any of the Company's operations or picket any of the Company's Warehouses or premises until all the bargaining procedure as outlined in this Agreement has been exhausted, and in no case on which the Umpire shall have ruled, and in no other case on which the Umpire is not empowered to rule until

after negotiations have continued for at least five days at the third step of the Grievance Procedure and not even then unless authorized by the International Union, United Automobile, Aircraft and Agricultural Implement Workers of America, CIO, and written notice of such intention to authorize has been delivered to the Personnel Staff of the Company at least five (5) days prior to such authorization. The Union will not cause or permit its members to cause nor will any member of the Union take part in any strike or stoppage of any of the Company's operations, or picket any of the Company's plants or premises because of any dispute or issue arising out of or based upon the provisions of the Pension Plan or the Insurance Program; nor will the Union authorize such a strike, stoppage, or picketing. In case a strike or stoppage of production shall occur, the Company has the option of cancelling the Agreement at any time after the strike occurs and the day of its settlement. The Company reserves the right to discipline any employe taking part in any violation of this Section of this Agreement.

* * * *

It may be of interest to refer merely by title to the sections of the Agreement omitted—Loss of Seniority, Layoff and Rehiring Procedure, General Provisions Regarding Seniority, Disciplinary Layoffs and Discharges, Union Bulletin Boards, Vacation Pay Allowances, Leaves of Absence, Leave of Absence for Military Service, Educational Leave of Absence for Veterans, Holiday Pay, General Provisions, Pension Plan and Insurance Program, and some Supplemental Agreements.—EDITOR'S NOTE.

37

THE LITTLE STEEL FORMULA

JOHN T. DUNLOP

THE LITTLE STEEL FORMULA was intended to set a limit to the increase in the general level of wages arising from across-the-board increases applicable to all employees in a bargaining unit, plant, industry, or other customary area of wage setting. The Little Steel formula permitted an increase in straight-time hourly earnings of 15 percent over the January 1941 levels. It was intended to permit laggard groups of employees to receive increases already obtained by the majority of workers. In postwar language, it was intended to complete a round of wage increases.

The 15 percent figure in the Little Steel formula was derived from the percentage increase in the cost of living despite the fact that the wage stabilization program fundamentally involved a separation of wage and price controls, with the announced intention of stabilizing both at, or as near as practicable, their September 1942 levels. Since wage and price controls were to be separated, it might have been more convincing if the allowable increase under such a formula had not been related to cost-of-living changes. It might have been possible, for example, to adopt a figure (in cents per hour) based upon the average increase in the wage rate of employees who had received increases between January 1941 and May 1942.

The attempt to separate wage and price controls is itself open to question, as has been noted. The device of tying wages to prices explicitly, at least within some limits, has the advantage of intensifying the interest of other economic groups in the community, such as industrial management and agriculture, in the stabilization of the cost of living.

The use of a percentage figure in the Little Steel formula had the effect of providing larger cents per hour increases for employees in higher-paid establishments than for lower-paid groups. In a period when the economic forces at work in the labor market were operating to narrow wage rate differentials, it was unfortunate that the Little Steel formula should have operated to have increased the cents per hour differentials among different groups of workers. If the formula had been expressed in cents per hour this limitation might have been avoided.

The adoption of any limitation on across-the-board increases inevitably tended to create the notion of a right to such increases. Stabilization essentially involved holding the higher wage rates and narrowing the differentials among lower-paid employees starting from a period in which differentials reflected labor markets with substantial unemployment. The Little Steel formula tended to create in the minds of the highest paid employees a right to an increase, thus making more difficult the task of holding the top rates.

38 ·

LABOR-MANAGEMENT RELATIONS ACT, 1947 (TAFT-HARTLEY LAW)

AN ACT: To amend the National Labor Relations Act, to provide additional facilities for the mediation of labor disputes affecting commerce, to equalize legal responsibilities of labor organizations and employers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE AND DECLARATION OF POLICY

SECTION 1. (a) This Act may be cited as the "Labor-Management Relations Act, 1947."

(b) Industrial strife which interferes with the normal flow of commerce and with the full production of articles and commodities for commerce, can be avoided or substantially minimized if employers, employees, and labor organizations each recognize under law one another's legitimate rights in their relations with each other, and above all recognize under law that neither party has any right in its relations with any other to engage in acts or practices which jeopardize the public health, safety, or interest.

It is the purpose and policy of this Act, in order to promote the full flow of commerce, to prescribe the legitimate rights of both employees and employers in their relations affecting commerce, to provide orderly and peaceful procedures for preventing the interference by either with the legitimate rights of the other, to protect the rights of individual employees in their relations with labor organizations whose activities affect commerce, to define and proscribe practices on the part of labor and management which affect commerce and are inimical to the general welfare, and to protect the rights of the public in connection with labor disputes affecting commerce.

TITLE I—AMENDMENT OF NATIONAL LABOR RELATIONS ACT

SEC. 101. The National Labor Relations Act is hereby amended to read as follows:

FINDINGS AND POLICIES

SECTION 1. The denial by some employers of the right of employees to organize and the refusal by some employers to accept the procedure of collective bargaining lead to strikes and other forms of industrial strife or unrest, which have the intent or the necessary effect of burdening or obstructing commerce by (a) impairing the efficiency, safety, or operation of the instrumentalities of commerce; (b) occurring in the current of commerce; (c) materially affecting, restraining, or controlling the flow of raw materials or manufactured or processed goods from or into the channels of commerce, or the prices of such materials or goods in commerce; or (d) causing diminution of employment and wages in such volume as substantially to impair or disrupt the market for goods flowing from or into the channels of commerce.

The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and

employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry and by preventing the stabilization of competitive wage rates and working conditions within and between industries.

Experience has proved that protection by law of the right of employees to organize and bargain collectively safeguards commerce from injury, impairment, or interruption, and promotes the flow of commerce by removing certain recognized sources of industrial strife and unrest, by encouraging practices fundamental to the friendly adjustment of industrial disputes arising out of differences as to wages, hours, or other working conditions, and by restoring equality of bargaining power between employers and employees.

Experience has further demonstrated that certain practices by some labor organizations, their officers, and members have the intent or the necessary effect of burdening or obstructing commerce by preventing the free flow of goods in such commerce through strikes and other forms of industrial unrest or through concerted activities which impair the interest of the public in the free flow of such commerce. The elimination of such practices is a necessary condition to the assurance of the rights herein guaranteed.

It is hereby declared to be the policy of the United States to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization, and designation of representatives of their own choosing, for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection.

* * * *

RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8 (a) (3).

UNFAIR LABOR PRACTICES

Sec. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

(2) to dominate or interfere with the formation or administration of any labor organization or contribute financial or other support to it: *Provided,* That subject to rules and regulations made and published by the Board pursuant to section 6, an employer shall not be prohibited from permitting employees to confer with him during working hours without loss of time or pay;

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization: *Provided,* That nothing in this Act, or in any other statute of the United States, shall preclude an employer from making an agreement with a labor organization (not established, maintained, or assisted by any action defined in section 8 (a) of this Act as an unfair labor practice) to require as a condition of employment membership therein on or after the thirtieth day following the beginning of such employment or the effective date of such agreement, whichever is the later, (i) if such labor organization is the representative of the employees as provided in section 9 (a), in the appropriate collective-bargaining unit covered by such agreement when made; and (ii) if, following the most recent election held as provided in section 9 (e) the Board shall have certified that at least a majority of the employees eligible to vote in such election have voted to authorize such labor organization to make such an agreement: *Provided further,* That no employer shall justify any discrimination against an employee for nonmembership in a labor organization (A) if he has reasonable grounds for believing that such membership was not available to the employee on the same terms and conditions generally applicable to other members, or (B) if he has reasonable grounds for believing that membership was denied or terminated for reasons other than the failure of the employee to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership;

(4) to discharge or otherwise discriminate against an employee because he has filed charges or given testimony under this Act;

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9 (a).

(b) It shall be an unfair labor practice for a labor organization or its agents—

(1) to restrain or coerce (A) employees in the exercise of the rights

guaranteed in section 7: *Provided,* That this paragraph shall not impair the right of a labor organization to prescribe its own rules with respect to the acquisition or retention of membership therein; or (B) an employer in the selection of his representatives for the purposes of collective bargaining or the adjustment of grievances;

(2) to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a) (3) or to discriminate against an employee with respect to whom membership in such organization has been denied or terminated on some ground other than his failure to tender the periodic dues and the initiation fees uniformly required as a condition acquiring or retaining membership;

(3) to refuse to bargain collectively with an employer, provided it is the representative of his employees subject to the provisions of section 9 (a);

(4) to engage in, or to induce or encourage the employees of any employer to engage in, a strike or a concerted refusal in the course of their employment to use, manufacture, process, transport, or otherwise handle or work any goods, articles, materials, or commodities or to perform any services, where an object thereof is: (A) forcing or requiring any employer or self-employed person to join any labor or employer organization or any employer or other person to cease using, selling, handling, transporting, or otherwise dealing in the products of any other producer, processor, or manufacturer, or to cease doing business with any other person; (B) forcing or requiring any other employer to recognize or bargain with a labor organization as the representative of his employees unless such labor organization has been certified as the representative of such employees under the provisions of section 9; forcing or requiring any employer to recognize or bargain with a particular labor organization as the representative of his employees if another labor organization has been certified as the representative of such employees under the provisions of section 9; (D) forcing or requiring any employer to assign particular work to employees in a particular labor organization or in a particular trade, craft, or class rather than to employees in another trade, craft, or class, unless such employer is failing to conform to an order or certification of the Board determining the bargaining representative for employees performing such work: *Provided,* That nothing contained in this subsection (b) shall be construed to make unlawful a refusal by any person to enter upon the premises of any employer (other than his own employer), if the employees of such employer are engaged in a strike ratified or approved by a representative of such employees whom such employer is required to recognize under this Act;

(5) to require of employees covered by an agreement authorized under subsection (a) (3) the payment, as a condition precedent to becoming a member of such organization, of a fee in an amount which the Board finds excessive or discriminatory under all circumstances. In making such a finding, the Board shall consider, among other relevant factors, the practices and customs of labor organizations in the particular industry, and the wages currently paid to the employees affected; and

(6) to cause or attempt to cause an employer to pay or deliver or agree to pay or deliver any money or other thing of value, in the name of an exaction, for services which are not performed or not to be performed.

(c) The expressing of any views, argument, or opinion, or the dissemination thereof, whether in written, printed, graphic, or visual form, shall not constitute or be evidence of an unfair labor practice under any of the provisions of this Act, if such expression contains no threat of reprisal or promise of benefit.

(d) For the purpose of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: *Provided,* That where there is in effect a collective-bargaining contract covering employees in an industry affecting commerce, the duty to bargain collectively shall also mean that no party to such contract shall terminate or modify such contract, unless the party desiring such termination or modification—

(1) serves a written notice upon the other party to the contract of the proposed termination or modification sixty days prior to the expiration date thereof, or in the event such contract contains no expiration date, sixty days prior to the time it is proposed to make such termination or modification;

(2) offers to meet and confer with the other party for the purpose of negotiating a new contract or a contract containing the proposed modifications;

(3) notifies the Federal Mediation and Conciliation Service within thirty days after such notice of the existence of a dispute, and simultaneously therewith notifies any State or Territorial agency established to mediate and conciliate disputes within the State or Territory where

the dispute occurred, provided no agreement has been reached by that time; and

(4) continues in full force and effect, without resorting to strike or lock-out, all the terms and conditions of the existing contract for a period of sixty days after such notice is given or until the expiration date of such contract, whichever occurs later.

The duties imposed upon employers, employees, and labor organizations by paragraphs (2), (3), and (4) shall become inapplicable upon an intervening certification of the Board, under which the labor organization or individual, which is a party to the contract, has been superseded as or ceased to be the representative of the employees . . . , and the duties so imposed shall not be construed as requiring either party to discuss or agree to any modification of the terms and conditions contained in a contract for a fixed period, if such modification is to become effective before such terms and conditions can be reopened under the provisions of the contract. Any employee who engages in a strike within the sixty-day period specified in this subsection shall lose his status as an employee of the employer engaged in the particular labor dispute . . . , but such loss of status for such employee shall terminate if and when he is reemployed by such employer.

* * * *

NATIONAL EMERGENCIES

SEC. 206. Whenever in the opinion of the President of the United States, a threatened or actual strike or lock-out affecting an entire industry or a substantial part thereof engaged in trade, commerce, transportation, transmission, or communication among the several States or with foreign nations, or engaged in the production of goods for commerce, will, if permitted to occur or to continue, imperil the national health or safety, he may appoint a board of inquiry to inquire into the issues involved in the dispute and to make a written report to him within such time as he shall prescribe. Such report shall include a statement of facts with respect to the dispute, including each party's statement of its position, but shall not contain any recommendations. The President shall file a copy of such report with the Service and shall make its contents available to the public.

* * * *

SEC. 208. (a) Upon receiving a report from a board of inquiry the President may direct the Attorney General to petition any district court of the United States having jurisdiction of the parties to enjoin

such strike or lock-out or the continuing thereof, and if the court finds that such threatened or actual strike or lock-out

(i) affects an entire industry or a substantial part thereof . . . ; and

(ii) if permitted to occur or continue, will imperil the national health or safety, it shall have jurisdiction to enjoin any such strike or lock-out, or the continuing thereof, and to make such orders as may be appropriate.

(b) In any case, the provisions of the Act of March 23, 1932, entitled "An Act to amend the Judicial Code and to define and limit the jurisdiction of courts sitting in equity, and for other purposes" (The Norris-LaGuardia Act), shall not be applicable.

* * * *

RESTRICTION ON POLITICAL CONTRIBUTIONS

SEC. 304. Section 313 of the Federal Corrupt Practices Act . . . is amended to read as follows:

SEC. 313. It is unlawful . . . for any corporation whatever, or for any labor organization to make a contribution or expenditure in connection with any election at which Presidential and Vice Presidential electors or a Senator or Representative . . . are to be voted for, or in connection with any primary election . . . , or for any candidate . . . to accept or receive any contribution prohibited by this section.

* * * *

STRIKES BY GOVERNMENT EMPLOYEES

SEC. 305. It shall be unlawful for any individual employed by the United States or any agency thereof including wholly owned Government corporations to participate in any strike. Any individual employed by the United States or by any such agency who strikes shall be discharged immediately from his employment, and shall forfeit his civil service status, if any, and shall not be eligible for re-employment for three years by the United States or any such agency.

* * * *

39

THE VETO MESSAGE ON THE TAFT-HARTLEY ACT

PRESIDENT HARRY S. TRUMAN

TO THE HOUSE OF REPRESENTATIVES:

I return herewith, without my approval, H. R. 3020, the "Labor Management Relations Act, 1947."

I am fully aware of the gravity which attaches to the exercise by the President of his constitutional power to withhold his approval from an enactment of the Congress.

I share with the Congress the conviction that legislation dealing with the relations between management and labor is necessary. I heartily condemn abuses on the part of unions and employers, and I have no patience with stubborn insistence on private advantage to the detriment of the public interest.

But this bill is far from a solution of those problems.

When one penetrates the complex, interwoven provisions of this omnibus bill, and understands the real meaning of its various parts, the result is startling.

The bill taken as a whole would reverse the basic direction of our national labor policy, inject the Government into private economic affairs on an unprecedented scale, and conflict with important principles of our democratic society. Its provisions would cause more strikes, not fewer. It would contribute neither to industrial peace nor to economic stability and progress. It would be a dangerous stride in the direction of a totally managed economy. It contains seeds of discord which would plague this Nation for years to come.

Because of the far-reaching import of this bill, I have weighed its probable effects against a series of fundamental considerations. In each case I find that the bill violates principles essential to our public welfare.

I. The first major test which I have applied to this bill is whether it would result in more or less Government intervention in our economic life.

Our basic national policy has always been to establish by law standards of fair dealing and then to leave the working of the economic system to the free choice of individuals. Under that policy of economic freedom we have built our nation's productive strength. Our people have deep faith in industrial self-government with freedom of contract and free collective bargaining.

I find that this bill is completely contrary to that national policy of economic freedom. It would require the Government, in effect, to become an unwanted participant at every bargaining table. It would establish by law limitations on the terms of every bargaining agreement, and nullify thousands of agreements mutually arrived at and satisfactory to the parties. It would inject the Government deeply into the process by which employers and workers reach agreement. It would superimpose bureaucratic procedures on the free decisions of local employers and employees.

At a time when we are determined to remove as rapidly as practicable, Federal controls established during the war, this bill would involve the Government in the free processes of our economic system to a degree unprecedented in peacetime.

This is a long step toward the settlement of economic issues by government dictation. It is an indication that industrial relations are to be determined in the halls of Congress, and that political power is to supplant economic power as the critical factor in labor relations.

II. The second basic test against which I have measured this bill is whether it would improve human relations between employers and their employees.

Cooperation cannot be achieved by force of law. We cannot create mutual respect and confidence by legislative fiat.

I am convinced that this legislation overlooks the significance of these principles. It would encourage distrust, suspicion, and arbitrary attitudes.

I find that the National Labor Relations Act would be converted from an instrument with the major purpose of protecting the right of workers to organize and bargain collectively into a maze of pitfalls and complex procedures. As a result of these complexities employers and workers would find new barriers to mutual understanding.

The bill time and again would remove the settlement of differences from the bargaining table to courts of law. Instead of learning to live

together, employers and unions are invited to engage in costly, time-consuming litigation, inevitably embittering both parties.

The Congress has, I think, paid too much attention to the inevitable frictions and difficulties incident to the reconversion period. It has ignored the unmistakable evidence that those difficulties are receding and that labor-management cooperation is constantly improving. There is grave danger that this progress would be nullified through enactment of this legislation.

III. A third basic test is whether the bill is workable.

There is little point in putting laws on the books unless they can be executed. I have concluded that this bill would prove to be unworkable. The so-called "emergency procedure" for critical nation-wide strikes would require an immense amount of government effort but would result almost inevitably in failure. The National Labor Relations Board would be given many new tasks, and hobbled at every turn in attempting to carry them out. Unique restrictions on the Board's procedures would so greatly increase the backlog of unsettled cases that the parties might be driven to turn in despair from peaceful procedures to economic force.

IV. The fourth basic test by which I have measured this bill is the test of fairness.

The bill prescribes unequal penalties for the same offense. It would require the National Labor Relations Board to give priority to charges against workers over related charges against employers. It would discriminate against workers by arbitrarily penalizing them for all critical strikes.

Much has been made of the claim that the bill is intended simply to equalize the positions of labor and management. Careful analysis shows that this claim is unfounded. Many of the provisions of the bill standing alone seem innocent but, considered in relation to each other, reveal a consistent pattern of inequality.

The failure of the bill to meet these fundamental tests is clearly demonstrated by a more detailed consideration of its defects.

1. *The bill would substantially increase strikes.*

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2. *The bill arbitrarily decides, against the workers, certain issues which are normally the subject of collective bargaining, and thus restricts the area of voluntary agreement.*

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3. *The bill would expose employers to numerous hazards by which they could be annoyed and hampered.*

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4. *The bill would deprive workers of vital protection which they now have under the law.*

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5. *The bill abounds in provisions which would be unduly burdensome or actually unworkable.*

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6. *The bill would establish an ineffective and discriminatory emergency procedure for dealing with major strikes affecting the public health or safety.*

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7. *The bill would discriminate against employees.*

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8. *The bill would disregard in important respects the unanimous convictions of employer and labor representatives at the National Labor-Management Conference in November, 1945.*

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9. *The bill raises serious issues of public policy which transcend labor-management difficulties.*

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The most fundamental test which I have applied to this bill is whether it would strengthen or weaken American democracy in the present critical hour. This bill is perhaps the most serious economic and social legislation of the past decade. Its effects—for good or ill—would be felt for decades to come.

I have concluded that the bill is a clear threat to the successful working of our democratic society.

One of the major lessons of recent world history is that free and vital trade unions are a strong bulwark against the growth of totalitarian movements. We must, therefore, be everlastingly alert that in striking at union abuses we do not destroy the contribution which unions make to our democratic strength.

This bill would go far toward weakening our trade union move-

ment. And it would go far toward destroying our national unity. By raising barriers between labor and management and by injecting political considerations into normal economic decisions, it would invite them to gain their ends through direct political action. I think it would be exceedingly dangerous to our country to develop a class basis for political action.

I cannot emphasize too strongly the transcendent importance of the United States in the world today as a force for freedom and peace. We cannot be strong internationally if our national unity and our productive strength are hindered at home. Anything which weakens our economy or weakens the unity of our people—as I am thoroughly convinced this bill would do—I cannot approve.

In my message on the State of the Union which I submitted to the Congress in January, 1947, I recommended a step-by-step approach to the subject of labor legislation. I specifically indicated the problems which we should treat immediately. I recommend that, before going on to other problems, a careful, thorough and non-partisan investigation should be made, covering the entire field of labor-management relations.

The bill now before me reverses this procedure. It would make drastic changes in our national labor policy first, and would provide for investigation afterward.

There is still a genuine opportunity for the enactment of appropriate labor legislation this session. I still feel that the recommendations which I expressed in the State of the Union Message constitute an adequate basis for legislation which is moderate in spirit and which relates to known abuses.

For the compelling reasons I have set forth, I return H.R. 3020 without my approval.

Harry S. Truman

The White House,
June 20, 1947.

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BUSINESS SUCCESS

WOODROW WILSON

I HAVE ALWAYS BEEN INCLINED to believe that the business of the world was best understood by those men who were in the struggle not only for maintenance, but for success. The man who knows the strength of the tide is the man who is swimming against it, not the man who is floating with it. The man who is immersed in the beginnings of business, who is trying to get his foothold, who is trying to get other men to believe in him and lend him money and trust him to make profitable use of that money, is the man who knows what the business conditions in the United States are, and I would rather take his counsel as to what ought to be done for business than the counsel of any established captain of industry. The captain of industry is looking forward. The conditions of business change with every generation; change with every decade; are now changing at an almost breathless pace, and the men who have made good are not feeling the tides as the other men are feeling them. The men who have got into the position of captaincy, unless they are of unusual fiber, unless they are of unusually catholic sympathy, unless they have continued to touch shoulders with the ranks, unless they have continued to keep close communion with the men they are employing and the young men they are bringing up as their assistants, do not belong to the struggle in which we should see that every unreasonable obstacle is removed and every reasonable help afforded that public policy can afford.

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THE CARE AND FEEDING OF IDEAS

CURTIS H. GAGER

WHETHER MOST PEOPLE react as unfavorably as they do to the "brain storms" of others because of fear of failure, fear to sponsor something that later may prove silly, lack of courage to think differently, or whatever—it is important in the field of management to recognize and remember that they do.

Today, at this very moment, ideas are being born in the mind of the housewife for new household improvements, in the mind of the country doctor for new medical aids; and in research laboratories all over the world. Other ideas are taking shape in the minds of people of every description. Many ideas, no doubt, which through months or years of research, experimentation, and development, may grow to be contributions—or which, because of starvation, will die and be lost.

Marketing experts are eminently familiar with the propagation of ideas. The large field of marketing research is one of the valuable executive factors in the care and feeding of ideas. This field has been of incalculable aid both in the social sciences and in determining consumers' viewpoints, their needs and wants in pre-testing products, and in determining the best and most suitable markets for them. It stimulates and enlivens competition for the consumer's favor. This, in turn, translated into actual improvements in products and services, increases the general welfare, improves values, lowers prices, and encourages the availability of thousands of products in the marketplace. Market research is important not alone in discovering and identifying new ideas but in evaluating and aiding in the selection of existing concepts so that the most worthy ideas can be given further study.

The care and feeding of ideas bears importantly on your job and your interests in the management of a business. For an idea is simply a helpless child of the brain if left to fend for itself. No matter how amazing or exciting, it is valueless both to its creator and to society unless and until it is finally put to work.

What is the alchemy by which ideas are transmuted from thought into actual being?

To become a reality, an idea must first *be given away to be kept.* At birth it is an intellectual amœba—helpless to do for itself. Its cell growth has not begun and cannot begin at all unless it has been exposed to, and accepted by, the minds of people who have the qualifications to nurture the idea to maturity.

And here we come squarely to management, for management *is* the process of the care and feeding of ideas. Just as with the child's birth, parents are born—so with the birth of an idea, an opportunity for management is born. Just as a child has parents for its care and feeding, so with ideas management serves this vitalizing function. The processing of ideas brings management into existence. Their nurture is management's positive reason for being.

A strong characteristic of progressive management has been to *search out* the intellectual products of the scientific laboratory, to study the market-place and basic wants of the consumer, and through this knowledge to find ways of translating these wishes and these needs into practical, tangible, satisfying reality. This peculiar talent of shaping ideas into new services or products is one of the characteristics of American life.

Certainly the word "management" has meant many things to many people. To a vast number, management means "the company." To an even larger number, it means "the boss." Some confuse management with stockholders—others with the board of directors. Still others identify management with money or financial power. Workers everywhere look to management for jobs.

None of these definitions for "management" recognizes management's true function as an idea-using enterprise. None contemplates the scope of the responsibility management involves and the range of talents necessary to carry out these multiple responsibilities. The spirit with which management serves both itself and society combines the daring of an explorer with all the risks of the adventurer into the unknown. This energizing motivation, coupled with management's belief in ideas and men, is astonishingly little known.

The care and feeding of ideas is a function of management which demands the full range of its talent. This is not a talent which can be

explained simply, for the process of growth by which an idea is changed to reality is frequently slow, often discouraging, invariably costly, and inherently complicated. No matter what the idea, the instinctive reactions to it are usually negative.

The manager's first reaction in this role must be faith—a will to hear an idea out, the patience to study it through and determine the reasons which may spell failure or success—faith to inspire others and to teach them. One of the most important attributes of enlightened management is a combination of faith with the ability to teach and inspire and investigate, thus overcoming the common unwillingness to change which is so fatal to new ideas.

To men and women unfamiliar with the problems of management and its varied requirements, it may seem that all one needs is a great new invention and, ergo, success will be automatic. This is far from the truth. It takes hundreds of applied ideas to operate any business. Any one basic new product will require exhaustive examination and investigation. Realizing that a single basic idea of any kind needs to be fed with all the little ideas, which of themselves when born and applied are to make the basic idea work, leads a wise management to do everything within its power to create, protect, and provide the optimum in climate, environment, and growing conditions for the ideas needed in a business. In this way the maximum number can be born, examined, nourished, and applied. It is in this kind of environment that the ultimate of cooperation and coordination may be achieved.

First of all, management must have convictions about its relation to society. Though these convictions are not often spelled out in carefully worded language, they exist. Management's unwritten code of sound ethics has become more and more widely accepted and practiced. Perhaps these convictions have a two-fold origin. In finding that they pay in a literal sense, it is realized increasingly that the reason for this is that they pay fully in terms of human satisfaction.

Basic to all convictions is management's self-imposed responsibility *to treat the public,* which includes workers, owners, and consumers, *with fairness.* The ancient rule of "caveat emptor" is no longer popular, neither was it ever practical. Management recognizes that a business succeeds only if the ideas it uses and on which it is founded serve the public, and only if, in the process of bringing the new products and services to maturity, it gains a justified reputation for fairness and right-dealing with all segments of that public.

Within its framework of good will, management feels a second deep conviction—*the responsibility to make a profit.* Without profits,

management is helpless to accept and bring new ideas into being. Only constantly improved service can create continuing profit. The manager sees profit as the life-blood for new ideas, the source of new jobs, and hence the means to improve human satisfactions of every material nature.

A third basic conviction is management's belief in *competition* as a stimulant to imagination, alertness, initiative, and top performances; in short, as the best possible environment in which ideas can be offered, adopted, cultivated, and caused to grow.

The economic environment of competition is one of the strongest incentives both toward the birth of new ideas upon which it puts a premium, and toward overcoming the negative reactions and lethargy with which new ideas are often greeted.

Individuals sharpen their abilities in a competitive environment where ideas are in constant competition with dozens or even hundreds of other ideas. They survive only if they are practical and socially useful. Management, ever aware that the consumer vote—by purchase—will spell failure or success, can never be satisfied that the *best* way to do something has been found. The manager must continually find *better* ways, for while competition backed up with consumers' favor strengthens, it also prunes out and destroys the weak products and inadequate services.

This is a rudimentary list of the ethical convictions which guide most managers. Even so, its implementation poses tremendous problems. With the strongest beliefs about what it would like to do to build good will, management must strive to keep all the elements in balance.

If the management fails partially in realizing these ends, it may sometimes be due to unwillingness or inability to accept them. More often, however, management's failures or shortcomings are due to the complexity and variety of the problems it has the responsibility to solve.

Progressive management believes that practical leadership requires a stubborn striving toward all the objectives which comprise better human relationships in the business. The manager faces day by day no greater trial than that of understanding the human spirit better

The successful manager, to accomplish his goals, must be able to recognize that each and every individual has certain predominant qualities, that people vary in their training, abilities, and experience. He must be able to deal with them on the basis of developing cooperation and coordination among these dissimilar qualities and training, dissimilar skills and personalities. He must cultivate the art of adminis-

tration, an art concerned first of all with the human part of his undertaking.

Ideas cannot survive in a negative atmosphere. One of the necessary tools and skills that management must have in this task of leadership is creating a positive atmosphere through communication. In a small business one man must do it all. In larger businesses, where more people are involved, the work of managing must be divided and shared. This multiplies communication difficulties and the possibility of human misunderstandings.

The results of all the activities must be watched, and while the entire process of business is under way, information about the business itself, its purposes, its prime objectives and problems, its difficulties and its needs must be kept flowing through the whole chain of human beings comprising it. Management must learn continually from *all* sources how better to develop ways of teaching and stimulating people.

The care and feeding of ideas—business administration—is really not a science. However, so long as the responses of people as individuals are unpredictably varied, managing must remain a challenging and fascinating art.

All the while, using all the facts he can get, the true business builder must be an organizer and a planner. Business is not done in a vacuum. The manager must be adaptable to a dynamic situation which is ever changing. Hour by hour the economic climate changes; problems, objectives, markets, competition are subject to rapid change. There are bound to be organizational changes, and human changes in the division of duty, delegation of authority, ability, and responsibility. The plant changes, both in process and facility, and in turn the products and packages change—all these and other factors are in continual flux. They necessitate a constant search for new ideas in all phases of the business.

There are many varieties of special skills and techniques of administration in addition to those required for treating with manufacturing, raw materials, research, engineering, law, distribution, accounting, finance, marketing, public relations—with all of which management must be familiar in order to direct and utilize the capacities of people and thereby nurture the ideas needed in the business.

Briefly, I should like to summarize my principal points on the care and feeding of ideas. It may be said first that ideas are met as a rule by a rude climate. The cold breath of disbelief withers and cuts them down. People are not enthusiastic for change. They may even dislike change.

Secondly, human nature is such that new ideas are immediately confronted with an imposing array of reasons why they should be discarded at once. It is a responsibility of keen management to determine what may be found in an idea, to discover if it has a germ that may be made to grow successfully.

Thirdly, if an idea is to live at all, it has to be given away. If it cannot be acquired by other minds, it will probably die. Enthusiasm and interest in it must be felt by all the minds needed to give it life and growth and stature.

Even a rude and unbecoming "brain child" may be diverted and changed into one of practical value by seeking for the way to make an idea work, by looking at each idea for its possibilities rather than solely for its impossibilities.

This concept is a function of management so important as to deserve much emphasis and repetition. Management's job is engaged with creating circumstances and environment which will help ideas to be conceived and born; and, if they can be applied, they may be aided to grow and become of practical value.

Managing a business—giving care and nourishment to the hundreds of ideas which must reach maturity if the business itself is to succeed—giving food and nutrition to the important product and service ideas on which jobs are founded and flourish—is a task which calls for many talents. There is no task in life which day by day needs more insight, more application, more wisdom, more tolerance and patience, than that of bringing the idea requirements of a business to full maturity.

If in giving you an overly simple story of this process of management and the men who comprise it, I have failed, it is because the magnitude of the story is beyond a simple telling.

The men who compose management are the keystone of our American economic system, and of progress everywhere. They alone, through their knowledge of people, through their belief in sound convictions, through their imagination and ability to plan, through abundant use of specific knowledge, through their courage and their belief in Man—exercise an influence over the complex process by which ideas become products and forces in society and material benefits to mankind the world over.

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ORGANIZATION AND PROPERTY

A. A. BERLE and G. C. MEANS

CORPORATIONS HAVE CEASED TO BE MERELY LEGAL DEVICES through which the private business transactions of individuals may be carried on. Though still much used for this purpose, the corporate form has acquired a larger significance. The corporation has, in fact, become both a method of property tenure and a means of organizing economic life. Grown to tremendous proportions, there may be said to have evolved a "corporate system"—as there was once a feudal system—which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a major social institution.

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Organization of property has played a constant part in the balance of powers which go to make up the life of any era. We need not resolve the controversy as to whether property interests are invariably controlling. The cynical view of many historians insists that property interests have at all times, visible or invisible, been dominant. Following this grim analysis, one commentator on the rise of corporations observed that they had become the "master instruments of civilization." Another expressed his depression at the fact that the system had at length reached a point definitely committing civilization to the rule of a plutocracy. Still others have seen in the system a transition phase towards ultimate socialism or communism. Acceptance of any of these beliefs may be delayed; but the underlying thought expressed in them all is that the corporate system has become the principal factor in economic organization through its mobilization of property interests.

In its new aspect the corporation is a means whereby the wealth of innumerable individuals has been concentrated into huge aggregates and whereby control over this wealth has been surrendered to a unified direction. The power attendant upon such concentration has brought forth princes of industry, whose position in the community is yet to be defined. The surrender of control over their wealth by investors has effectively broken the old property relationships and has raised the problem of defining these relationships anew. The direction of industry by persons other than those who have ventured their wealth has raised the question of the motive force back of such direction and the effective distribution of the returns from business enterprise.

These corporations have arisen in field after field as the myriad independent and competing units of private business have given way to the few large groupings of the modern quasi-public corporation. The typical business unit of the 19th century was owned by individuals or small groups; was managed by them or their appointees; and was, in the main, limited in size by the personal wealth of the individuals in control. These units have been supplanted in ever greater measure by great aggregations in which tens and even hundreds of thousands of workers and property worth hundreds of millions of dollars, belonging to tens or even hundreds of thousands of individuals, are combined through the corporate mechanism into a single producing organization under unified control and management. Such a unit is the American Telephone and Telegraph Company, perhaps the most advanced development of the corporate system. With assets of almost five billions of dollars, with 454,000 employees, and stockholders to the number of 567,694, this company may indeed be called an economic empire—an empire bounded by no geographical limits, but held together by centralized control. (Figures for 1950: assets, $6,246,441,895; number of employees, 602,466; number of stockholders, May 15, 1951, 1,000,000.) One hundred companies of this size would control the whole of American wealth; would employ all of the gainfully employed; and if there were no duplication of stockholders, would be owned by practically every family in the country.

Such an organization of economic activity rests upon two developments, each of which has made possible an extension of the area under unified control. The factory system, the basis of the industrial revolution, brought an increasingly large number of workers directly under a single management. Then, the modern corporation, equally revolutionary in its effect, placed the wealth of innumerable individuals under the same central control. By each of these changes the

power of those in control was immensely enlarged and the status of those involved, worker or property owner, was radically changed. The independent worker who entered the factory became a wage laborer surrendering the direction of his labor to his industrial master. The property owner who invests in a modern corporation so far surrenders his wealth to those in control of the corporation that he has exchanged the position of independent owner for one in which he may become merely recipient of the wages of capital.

In and of itself, the corporate device does not necessarily bring about this change. It has long been possible for an individual to incorporate his business even though it still represents his own investment, his own activities, and his own business transactions; he has in fact merely created a legal *alter ego* by setting up a corporation as the nominal vehicle. If the corporate form had done nothing more than this, we should have only an interesting custom according to which business would be carried on by individuals adopting for that purpose certain legal clothing. It would involve no radical shift in property tenure or in the organization of economic activity; it would inaugurate no "system" comparable to the institutions of feudalism.

The corporate system appears only when this type of private or "close" corporation has given way to an essentially different form, the quasi-public corporation: a corporation in which a large measure of separation of ownership and control has taken place through the multiplication of owners.

Such separation may exist in varying degrees. Where the men ultimately responsible for running a corporation own a majority of the voting stock while the remainder is widely diffused, control and part ownership are in their hands. Only for the remaining owners is there separation from control. Frequently, however, ownership is so widely scattered that working control can be maintained with but a minority interest. The Rockefeller family, for example, is reported to have retained direct or indirect minority interests in many of the Standard Oil Companies; and in the case of the Standard Oil Company of Indiana, this interest, amounting to only 14.5 per cent, combined with the strategic position of its holders, has proved sufficient for the control of the corporation. In such a case the greater bulk of ownership is virtually without control. Separation of ownership and control becomes almost complete when not even a substantial minority interest exists, as in the American Telephone and Telegraph Company, whose largest holder is reported to own less than one per cent of the company's stock. Under such conditions

control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding. In each of these types, majority control, minority control, and management control, the separation of ownership from control has become effective—a large body of security holders has been created who exercise virtually no control over the wealth which they or their predecessors in interest have contributed to the enterprise. In the case of management control, the ownership interest held by the controlling group amounts to but a very small fraction of the total ownership. Corporations where this separation has become an important factor may be classed as quasi-public in character in contradistinction to the private, or closely held corporation in which no important separation of ownership and control has taken place.

Growing out of this separation are two characteristics, almost as typical of the quasi-public corporation as the separation itself—mere size and the public market for its securities. It is precisely this separation of control from ownership which makes possible tremendous aggregations of property. The Fords and the Mellons, whose personal wealth is sufficient to finance great enterprises, are so few, that they only emphasize the dependence of the large enterprise on the wealth of more than the individual or group of individuals who may be in control. The quasi-public corporation commands its supply of capital from a group of investors frequently described as the "investing public." It draws these savings to itself either directly, as individuals purchase stocks or bonds, or indirectly, as insurance companies, banks, and investment trusts receive these savings and invest them in corporate securities. To secure these funds it must commonly avail itself of an open market in its securities—usually by listing shares on a stock exchange, or, less importantly, by maintaining a private or "unlisted" market. So essential, in fact, is the open market to the quasi-public corporation that it may be considered almost as characteristic of that type of corporation as the separation of ownership from control and the great aggregation of wealth.

These characteristics are not invariable. The private corporation may be, and in a few instances is, exceedingly large; witness the Ford Motor Company. . . . Private or "close" corporations may and occasionally do avail themselves of a public market for their shares; the Aluminum Company of America, though most of its stock is closely held, has its shares listed on the New York Curb Exchange, and a small fraction of its stock is traded in there. But these instances are so exceptional as to prove the rule. In the overwhelming bulk of cases, corporations fall into the quasi-public class when they rep-

resent large aggregations of wealth and their securities are available in the open market; for in such corporations part or most of the owners have almost invariably surrendered control.

Though the American law makes no distinction between the private corporation and the quasi-public, the economics of the two are essentially different. The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear. Size alone tends to give these giant corporations a social significance not attached to the smaller units of private enterprise. By the use of the open market for securities, each of these corporations assumes obligations towards the investing public which transform it from a legal method clothing the rule of a few individuals into an institution at least nominally serving investors who have embarked their funds in its enterprise. New responsibilities towards the owners, the workers, the consumers, and the State thus rest upon the shoulders of those in control. In creating these new relationships, the quasi-public corporation may fairly be said to work a revolution. It has destroyed the unity that we commonly call property—has divided ownership into nominal ownership and the power formerly joined to it. Thereby the corporation has changed the nature of profit-seeking enterprise. . . .

Examination of the changes produced can properly commence with the new relationships between the owners on the one hand and control on the other. . . . This involves the area roughly termed "corporation finance"—the relations between the corporation as managed by the group in control, and those who hold participations in it—its stockholders, bondholders, and, to some extent, its other creditors. . . . Here we are concerned only with a fundamental change in the form of property, and in the economic relationships which rest upon it.

Outwardly the change is simple enough. Men are less likely to own the physical instruments of production. They are more likely to own pieces of paper, loosely known as stocks, bonds, and other securities, which have become mobile through the machinery of the public markets. Beneath this, however, lies a more fundamental shift. Physical control over the instruments of production has been surrendered in ever-growing degree to centralized groups who manage property in bulk, supposedly, but by no means necessarily, for the benefit of the security holders. Power over industrial property has been cut off from the beneficial ownership of this property—or, in less technical language, from the legal right to enjoy its fruits. Con-

trol of physical assets has passed from the individual owner to those who direct the quasi-public institutions, while the owner retains an interest in their product and increase. We see, in fact, the surrender and regrouping of the incidence of ownership, which formerly bracketed full power of manual disposition with complete right to enjoy the use, the fruits, and the proceeds of physical assets. There has resulted the dissolution of the old atom of ownership into its component parts, control and beneficial ownership.

This dissolution of the atom of property destroys the very foundation on which the economic order of the past three centuries has rested. Private enterprise, which has molded economic life since the close of the Middle Ages, has been rooted in the institution of private property. Under the feudal system, its predecessor, economic organization grew out of mutual obligations and privileges derived by various individuals from their relation to property which no one of them owned. Private enterprise, on the other hand, has assumed an owner of the instruments of production with complete property rights over those instruments. Whereas the organization of feudal economic life rested upon an elaborate system of binding customs, the organization under the system of private enterprise has rested upon the self-interest of the property owner—a self-interest held in check only by competition and the conditions of supply and demand. Such self-interest has long been regarded as the best guarantee of economic efficiency. It has been assumed that, if the individual is protected in the right both to use his own property as he sees fit and to receive the full fruits of its use, his desire for personal gain, for profits, can be relied upon as an effective incentive to his efficient use of any industrial property he may possess.

In the quasi-public corporation, such an assumption no longer holds. As we have seen, it is no longer the individual himself who uses his wealth. Those in control of that wealth, and therefore in a position to secure industrial efficiency and produce profits, are no longer, as owners, entitled to the bulk of such profits. Those who control the destinies of the typical modern corporation own so insignificant a fraction of the company's stock that the returns from running the corporation profitably accrue to them in only a very minor degree. The stockholders, on the other hand, to whom the profits of the corporation go, cannot be motivated by those profits to a more efficient use of the property, since they have surrendered all disposition of it to those in control of the enterprise. The explosion of the atom of property destroys the basis of the old assumption that the quest for profits will spur the owner of industrial property to its effective use. It consequently challenges the fundamental economic principle of individual

initiative in industrial enterprise. It raises for reexamination the question of the motive force back of industry, and the ends for which the modern corporation can be or will be run.

The corporate system further commands attention because its development is progressive, as its features become more marked and as new areas come one by one under its sway. Economic power, in terms of control over physical assets, is apparently responding to a centripetal force, tending more and more to concentrate in the hands of a few corporate managements. At the same time, beneficial ownership is centrifugal, tending to divide and subdivide, to split into ever smaller units and to pass freely from hand to hand. In other words, ownership continually becomes more dispersed; the power formerly joined to it becomes increasingly concentrated; and the corporate system is thereby more securely established.

This system bids fair to be as all-embracing as was the feudal system in its time. It demands that we examine both its conditions and its trends, for an understanding of the structure upon which will rest the economic order of the future.

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THE GENERAL FORMS OF FINANCIAL ORGANIZATION

FLOYD F. BURTCHETT

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THE FINANCIAL ORGANIZATION of modern industry is vastly different from that in any other stage in the economic development of society by reason of its complexity and by reason of its diverse and variant forms. . . .

By financial organization is meant the same thing as is frequently implied by ownership organization; it is the viewpoint of property

rights and values; it is an analysis of the powers, rights, privileges, duties, liabilities and financial responsibilities concomitant to the participation of individuals and institutions in economic activity through the individual or group ownership of property rights or capital. Generally speaking, all structural organization for business purposes falls into one of two categories: 1) individual ownership, and 2) organized ownership. The former "concentrates all rights, privileges, and powers of control in one person, who has also the complete duty, full responsibility, and entire risk connected with the property owned"; the latter "is the result of an agreement of some kind between individuals whereby rights, powers and privileges are apportioned in a definite relation to duties, responsibilities, and risks." The distinction is clear enough from a legal point of view, but difficult to apply in actual practice, for there are corporations which amount to individual enterprises and there are individual enterprises and partnerships so involved by contracts as to have an organization which in effect approaches a corporation. The first type of financial organization involves but two parties, the individual and the state; the second must have three or more, the contracting parties and the state.

There are at least ten general forms of financial structural organizations with which the student of modern business finance should become acquainted. They are: the individual enterprise; the general partnership; the special partnership; the voluntary association; the joint-stock company; the corporation; the Massachusetts trust; the federation; the holding company; and the cartel. Some are more formal than others; some are more useful than others. . . .

[The individual enterprise, general partnership, the special partnership, and joint-stock company are treated below.—EDITORIAL NOTE]

THE INDIVIDUAL ENTERPRISE

This is the oldest and the simplest of all forms of business organization. The capital of such a business is restricted to what is owned by the individual or may be borrowed by him. The financial instruments are usually simple mortgages, notes, and the current finance instruments. Though by no means impossible, it is rare that an individual enterprise has a bond issue. The credit of the concern is limited by the property assets, the ability of the management, and the moral standing of the individual in the community, with his banker, and in the trade. Borrowing capacity is likely to be particularly limited where the success of the business is largely dependent upon the life and peculiar

abilities of a single individual. The individual enterprise is easily formed, operates with a minimum of state interference and regulation, is easily terminated, is easily changed in its operations, and contains a maximum of flexibility. Only the owner has any control over its affairs; hence, there need be no fear of internal politics, malfeasance of office, or manipulation of control.

The individual enterprise is often not the most useful form of business structure because of the relatively restricted capital, difficulty of financing, lack of public control over its financing, perhaps poor accounting records, the limitations of the individual's judgment and the business acumen as compared to that of a group, unlimited liability in the event of failure, inability to provide financial insulation for various business ventures, limited life and other elements which prevent private enterprises from growing to great size and having a longevity comparable to that of corporations. The number of individual enterprises appears not to be decreasing rapidly, although the proportion of business which is done by the individual enterprise appears to be decreasing. The very fact that it may be formed without outside judgment, upon short notice and with small expense sometimes makes it the means by which incompetent persons enter upon business ventures. In all other forms of business a corroborative judgment is required by other persons, and sometimes, as in the case of banks, public utility corporations, railroads, etc., public officials may have to be consulted. No one person, even if his wealth were sufficient, could expect the individual enterprise to grow to the point of being a serious competitor of the great corporation, for no man can be an expert in all of the varied specialized fields of modern industry.

THE GENERAL PARTNERSHIP

The general partnership, like the individual enterprise, is an old form of business organization. As compared to the individual enterprise, it has these advantages: greater capital by reason of the combined capital of the partners; greater management ability on the theory that two heads are better than one; specialization of function between the several partners; larger scale of operation; more intense application of capital in small-scale operations, hence a decrease in the cost of doing business in some types of enterprise; extension of credit of the concern beyond the assets and the personal credit of the single person, to the assets and personal credit of all the partners; better accounting methods because of the legal relationships of partners and the necessity of dividing profits. Finally, people who are incapable of efficiently performing all the functions of business may

combine with other persons whose ability covers their own deficiency, and vice versa, and thus be successful in business when such success would be utterly impossible for them in an individual enterprise, none of them being capable of successfully conducting business independently.

The general partnership, however, possesses numerous objectionable features from a financial standpoint. It is not possible to segregate or to insulate financially various economic activities in which a person of considerable wealth may desire to engage. If a man desired to participate in the operation of a wholesale grocery and a blast furnace, losses in either would, through the principle of unlimited liability in general partnership, be transmitted to the other. Damage suits arising in a very minor business could be enforced against the entire assets of the individual, hence increase materially the risk of doing business in whatever form. The fact that each partner is unlimitedly liable for the debts of the entire partnership sometimes causes persons of wealth to refrain from forming partnerships with persons of little wealth who could supplement the ability of the wealthy person in some special line of business. There is great difficulty, if not impossibility, in securing a sufficient quantity of capital to conduct large businesses in competition with the corporation. Thus, it would be almost impossible to secure sufficient capital by a partnership arrangement to form a General Motors organization. Inclusion of a great number of partners to secure the large quantity of capital would lead to cumbersomeness and probably to internal dissension. The fact that the partnership, like the individual enterprise, is liable to legal destruction by the death of a single partner restricts its financing operations to the lives of the partners. While bonds, collateral and mortgage, can be issued by partnerships, such bonds possess many undesirable characteristics not found in corporation bonds. Ownership cannot be separated from financial responsibility in the general partnership; however, this is a point of superiority over the corporation as the latter is frequently constituted today.

SPECIAL FORMS OF THE PARTNERSHIP

There are many variants of the partnership organization of business, each designed to meet some of the disadvantages above mentioned with respect to either the individual enterprise or the corporation, or both. In Texas, as well as in other states, what are known as limited partnerships are permitted under special statutes. Under this arrangement, the liability of the partners is limited somewhat in the same manner as that of a stockholder in a corporation; some state regulation is not infrequently imposed, and the public must be notified of

the fact that the partners do not have unlimited liability. Most states require limited partnerships to file their articles of agreement with some public official. If these limited partnerships conduct business in states other than that in which they are organized, they are usually treated the same as general partnerships by the courts, especially if they operate in a state which does not have statutes permitting limited partnerships. The line of demarcation between the limited partnership and the limited partnership association is difficult to draw in many instances. The latter is often legally referred to as a "quasi-corporation." These "quasi-corporations" usually issue shares not greatly different from corporation stock, and have limited liability. The public must be informed of the nature of the association, usually by the use of the word "Limited" or the abbreviation, "Ltd.," in the name of the concern. Ordinarily the shares are not freely transferable except by consent of the partners. Some states refuse to recognize this type of partnership and treat it as a general partnership.

THE JOINT-STOCK ASSOCIATION

In the special forms of partnerships it was noted that liability was sometimes limited but that transferability of shares was restricted. In the joint-stock association there may or may not be limited liability, but there is freedom in the transferability of shares. Moreover, limited partnerships may be formed only when special statutes have been enacted; unless there is a statute covering the point, joint-stock associations are entered into under the general common law as it applies to contracts. The joint-stock association or company is an arrangement which occupies a middle ground between the corporation and the general partnership.

Joint-stock associations are formed by drawing up a contract known as the articles of association. This contract usually gives the name of the association, date, place of business, nature of business, amount of shares, the rights, duties, methods of changing the articles, and provisions for the termination or dissolution of the business. Since trustees, because of the somewhat uncertain question of the existence of a legal entity in the joint-stock association, usually hold legal title to the property, it is customary to name them in the articles and to provide for their successors if necessary. The control of the joint-stock company theoretically rests in the shareholders, though in practice the representatives of the shareholders, the directors, perform the actual work of management, and the individual shareholders have no right to bind the association. The shareholders of the joint-stock company occupy a position almost parallel to that held by stockholders in ordinary corporations. Capital for the joint-stock company is obtained

through the sale of shares, preferred and common; through borrowing by means of the sale of bonds, debentures, notes, etc.; and by direct loans either from the trade or from financial institutions. In its financing operations the joint-stock association approaches the corporation. Lack of wide use is probably the only reason why a smaller variety of financing instruments have been used by these associations than by corporations. The joint-stock association is vastly superior to the partnership arrangement as far as raising capital is concerned; it is not equal to the corporation, however, by reason of the large liability upon individual shareholders. Most tax laws regard joint-stock associations as corporations *de facto* if not *de jure.*

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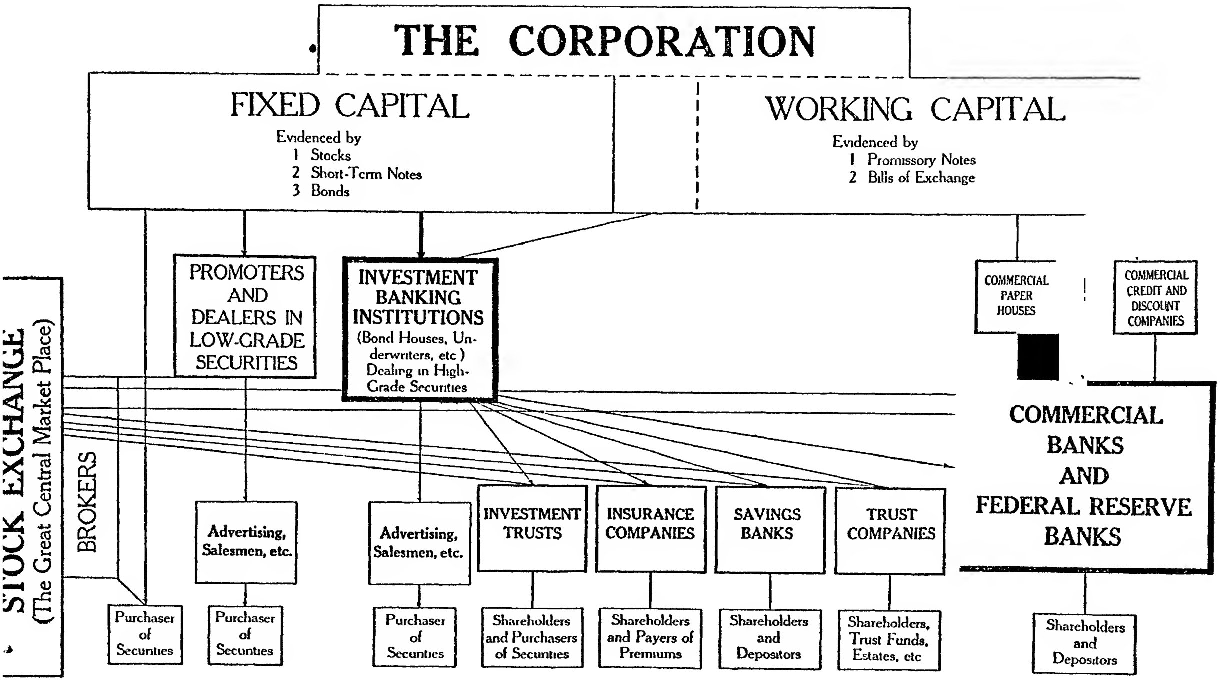
FINANCIAL INSTITUTIONS AND THE ASSEMBLING OF CAPITAL

H. G. MOULTON

THE GREAT GROWTH of credit operations which followed the development of large-scale business enterprise, particularly that organized on the corporate basis, has been attended by the development of an extensive and interdependent financial structure, designed to facilitate the raising of the funds required for capitalistic industry. The great number of financial instruments, agencies, and institutions that are utilized in connection with the borrowing operations of producing, manufacturing, and mercantile businesses is indicated in the diagram. . . .

In general, the purpose is to show the financial institutions and agencies that are employed in the assembling of the capital required by modern business enterprise. . . . The arrows pointing downward from fixed capital indicate the movement of the securities that are


THE CORPORATION
FIXED CAPITAL
Evidenced by
1 Stocks
2 Short-Term Notes
3 Bonds
WORKING CAPITAL
Evidenced by
1 Promissory Notes
2 Bills of Exchange
PROMOTERS AND DEALERS IN LOW-GRADE SECURITIES
INVESTMENT BANKING INSTITUTIONS (Bond Houses, Underwriters, etc) Dealing in High-Grade Securities
COMMERCIAL PAPER HOUSES
COMMERCIAL CREDIT AND DISCOUNT COMPANIES
STOCK EXCHANGE (The Great Central Market Place)
BROKERS
Advertising, Salesmen, etc.
Advertising, Salesmen, etc.
INVESTMENT TRUSTS
INSURANCE COMPANIES
SAVINGS BANKS
TRUST COMPANIES
COMMERCIAL BANKS AND FEDERAL RESERVE BANKS
Purchaser of Securities
Purchaser of Securities
Purchaser of Securities
Shareholders and Purchasers of Securities
Shareholders and Payers of Premiums
Shareholders and Depositors
Shareholders, Trust Funds, Estates, etc
Shareholders and Depositors

issued by corporations through the financial institutions that assist in marketing them to the ultimate purchasers, who in the last analysis furnish the funds to the corporation. In some cases the securities do not find lodgment with individual investors but are purchased by financial institutions, as is indicated by the arrows which point to savings banks, insurance companies, etc. In these cases, however, the funds are still furnished by individual savers, namely, the shareholders, depositors, etc. These financial institutions thus serve as intermediaries in the process of rendering individual savings available for the uses of corporate industry.

The stock market has been placed at one side of the diagram in order to indicate that it is seldom a direct intermediary in the marketing of securities. It is rather a great central market place which is made use of by nearly all of the various types of financial institutions in connection with their operations, as well as by the ultimate investors in securities. . . . The lines connecting the stock exchange with the different institutions are designed to indicate in a general way the interrelations that exist.

Finally, it will be seen that the commercial banks are directly concerned with the raising of working capital, and indirectly associated with investment banking institutions in the raising of fixed capital. Note the transverse line connecting commercial and investment banks. A line might also be drawn from the commercial banks to the fixed capital side of the corporation; for to a considerable extent they purchase securities directly and make loans to corporations for fixed capital purposes.

To safeguard against misconception it is necessary to state that the diagrams could not be made to reveal all the phases of the modern financial structure without complicating them to to the point of obscurity. It will be well, therefore, to point out here certain things which they do not indicate.

First, although a line is drawn from the corporation direct to the purchaser of securities, the corporation chart fails to convey an adequate idea of the vast amount of capital that is raised without the assistance of financial intermediaries. A very great number of our corporations have raised their capital by direct subscription; indeed, it may perhaps safely be said that a large percentage of our present-day corporations secured their start by converting individual firms or partnerships into corporations and issuing shares of stock to the owners. There are many "close" corporations—those which have never raised any funds from general subscription. Among some of the more important of such corporations are: most of the great New England cot-

ton mills; several of the larger chemical companies; the Du Pont Powder Company; many of the great department stores in all the large cities of the country; the large corporations in the aluminum, brass, zinc, asbestos, and sulphur industries; and the great majority of financial institutions. . . .

Second, the charts do not reveal the raising of capital by the common process of creating a surplus through setting aside a portion of the earnings for an expansion of the business. A tremendous amount of capital is thus raised, especially by corporations. It will be noted that this method merely involves a decision of the directors of the corporation with reference to the disposition of earnings.

Third, the charts reveal only those credit operations which involve the borrowing of funds, as distinguished from actual goods. Working capital in part takes the form of materials bought on credit. A retailer, for instance, may do most of his borrowing by buying goods from wholesalers on time. But since the wholesalers, who sell these goods on credit to the retailer, usually borrow from the commercial banks during the interval while awaiting payment, it all comes to much the same thing in the end—working capital is largely borrowed from the commercial banks.

The corporation chart does indicate, however, that a portion of the working capital is usually derived from the sale of securities. Indeed, if a business is to have a good credit standing with its bank, it must, in fact, provide a considerable part of its working capital by stock subscriptions.

Fourth, one might conclude from the corporation diagram that savings banks are associated only with the problem of raising fixed capital. As a matter of fact, many savings-bank loans are also made for working capital purposes.

Fifth, the position of the trust company in the financial structure of society is not adequately revealed. As the chart stands, the trust company is related only to the raising of fixed capital and is placed in a position parallel with savings banks and insurance companies. In fact, . . . the trust company performs so wide a variety of functions that it is impossible in the present diagram to indicate its relationship to the entire financial structure. The commercial banking department of the trust company would go with the commercial banks, the bond department with the bond-houses, the savings department with the savings banks, the insurance department with the insurance companies. But, in addition, the trust company performs a great variety of services for the holders of corporate securities in connection with the safekeeping of valuables, the holding of mortgages in trust, the trans-

fer of ownership of stocks and bonds, the financial reorganization of companies, etc.

Finally, the diagrams tend to give a false impression of specialization by financial institutions. The truth is that more and more there is being conducted under one roof and by a single administrative organization a great variety of financial activities.

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THE NEED AND SOURCE OF FUNDS

JOHN M. CHAPMAN

BUSINESS ENTERPRISES, if properly financed, need or require various types of funds which may be classified as follows: (1) short-term, (2) term loans or working capital or intermediate capital, and (3) permanent funds including equity funds and long-term bonds.

(1) Short-term loans are those which are obtained by business and usually run from three to six months but in some cases may extend for much longer periods. Trade credit granted by suppliers usually runs for 30 to 90 days. The funds obtained from short-term loans are generally used to meet payrolls and other current operating expenses including the payment or discounting of bills, re-stocking or maintaining of inventories or financing other current operations.

(2) Term loans are needed to improve the plant, to expand inventories, to add machinery and equipment and in some cases to expand the business by extending it into new territories or by the taking on of a new line. Such loans usually run from one to three years, but in some cases term loans are extended for five years or longer. In general the terms of repayment for each loan agreement are fixed to meet

the individual needs of the borrower with special reference to his prospective earning power and ability to pay the loan at maturity.

(3) Permanent funds are essentially of two kinds: (a) equity funds (venture or risk capital) and (b) long-term mortgage or bonds. Equity funds proper represent the original contribution or investments by enterprisers and other stockholders. Additions may be made through the same sources but most of the future additions from the owners will come through the plowing back of earnings. Long-term loans are sometimes obtained by small businesses. This type of funds is frequently referred to as "loan capital" to distinguish it from the permanent capital supplied by the shareholders. The distinction between this type of financing and term loans is not always easily fixed. Neither is there a clear line of distinction between the uses of equity funds and long-term credit funds.

SOURCES OF SHORT-TERM FUNDS FOR SMALL BUSINESS

Several types of financial institutions may be listed as possible sources of loan funds for small business. While there is no doubt that such individual sources are used extensively in certain localities or industries from time to time, it is reasonable to assume that most of these institutions are of minor importance as a source of funds. This general conclusion is justified because some of these sources are institutions which are either small or/and limited to certain geographical areas. Some of these agencies are highly specialized and intended to meet the needs of individuals or certain types of business firms. The following list includes the primary sources of short-term and intermediate or working funds for small business:

1. Private Sources

Commercial banks
Sales finance companies
Insurance companies
Factors
Wholesalers or suppliers
Industrial banks
Personal finance companies
Local chambers of commerce
Individuals
Cooperative groups of small businessmen

2. Government Agencies

Reconstruction Finance Corporation
Federal Reserve Banks
Commodity Credit Corporation
G. I. loans

Taking small business as a whole, the commercial banks are the most important source of short-term commercial and term loans. Banks offer a variety of loans which have been designed to meet the needs of different types of businessmen. These include commercial, agricultural, term, accounts receivable, installment credit, security loans, loans secured by warehouse receipts or other collateral of like nature, equipment loans and some loans secured by mortgages on real estate. For the country as a whole it is likely that banks will continue to be the primary source of short-term and term loans for small business in the years ahead.

TERM LOANS

Many small business firms have obtained "term loans" from their commercial banks. This type of fund may be regarded as a kind of "bridge" between long- and short-term financing. The "term loan" may properly be regarded as an addition to working capital—a type of fund which gives the concern more freedom in its operation, especially with regard to expansion in inventories and plant improvements. Even so the retirement of such loans is expected to be made out of the future earnings of the business. In a "way" it might be said that term loans are obtained in anticipation of future earnings. Working capital as distinct from fixed capital is frequently available from suppliers to small firms and corporations. In many cases inventories may be built up through an increase in accounts payable, or an increase in inventories through purchase of goods from suppliers on credit. . . .

In the cases where term loans or mortgage loans have been used to obtain permanent assets for use in the operations, the additions may be regarded as an increase of the investment when the loans have been retired from the earnings of the concern.

OTHER SOURCES OF COMMERCIAL AND TERM LOANS

The importance of other sources of credit for small business varies widely. For example, local chambers of commerce have, in some cases, proposed or developed local financial plans designed to encourage the investment of funds in the community. Such assistance may have been very substantial to a limited number of businessmen, but the over-all significance is definitely limited for different reasons. In the first place the general purpose has been to attract to the locality either old established businesses or new organizations rather than to act as a financier per se. Another limitation is the fact that only a

limited number of such financial plans have been definitely put into operation. Moreover, the success of financial programs depends to a large extent upon the general support of businessmen in the community. It is quite evident that the local chambers of commerce do not have access to a substantial body of funds which may be needed to encourage expansion of local industries or businesses. This, then, is not a very promising source of loan funds for small business enterprises.

Personal finance companies were brought into existence primarily to aid borrowers who needed relatively small amounts of consumer credit to meet old accounts or to buy durable consumer goods. Although a number of small businessmen have been aided by these financial institutions, it is evident that small businessmen cannot rely extensively upon these agencies for financial assistance.

Sales finance companies and insurance companies are much more important as lenders or financiers to business than personal finance companies, individuals or cooperative groups of small businessmen. Suppliers who finance the sale of goods or carry accounts receivable, are in many cases important.

The volume of the outstanding accounts receivable is often very large. "Suppliers' credit" frequently gives rise to an expansion of bank credit since many wholesalers extending trade credit are, in turn, forced to borrow from commercial banks or in the open market to finance their sales to retailers or jobbers. To the extent that "suppliers" are forced to borrow to carry such accounts, such financing constitutes an indirect demand for bank credit.

Factors, for example, are another source of credit for certain small businesses in given localities. Factors, however, are restricted in number and location; consequently, as an over-all source they hold a minor place as compared with commercial banks throughout the country. These institutions, together with personal finance companies, individuals, investment bankers, corporations, cooperative organizations and local chambers of commerce were never intended to be basic sources for commercial credit for business enterprise. In some cases they have advanced much needed funds but their contribution in relation to total amount of funds needed does not bulk large.

Life insurance companies, sales finance companies and industrial banks are specialized agencies which may increase or expand their operations in the future, but it is hardly to be expected that they will do more than provide a limited share of commercial or term loans wanted by small businessmen throughout the country. This is not "belittling the importance" of the services rendered but only to indicate the re-

stricted resources which are available for small businessmen. Wholesalers play an important role in financing many retailers. Such credit is far more important in volume than the amounts advanced by many cash lenders in the field. Such institutions frequently borrow from commercial banks in order to carry their accounts receivable. This enhances the importance of the commercial bank as a fundamental source of funds for all types of small business.

EQUITY CAPITAL VERSUS VENTURE CAPITAL

The terms "equity capital" and "venture capital" are frequently used rather loosely—in many cases interchangeably. They do not necessarily mean one and the same thing. Equity capital is generally used to refer to what the stockholders or owners of the enterprise have contributed to the business. Equity capital may refer to the original contribution when the business was organized or to later additions which may take the form of new (outside) contributions or retained earnings, or both. Stockholders or owners assume varying degrees of risk depending upon how well established the business has become. Capital funds should be clearly differentiated from those funds which have been advanced by creditors such as banks, bond holders, or others who have extended credit in one way or another to the firm. The claims of these various groups come ahead of the stockholders.

The various groups of stockholders do not take the same risk. The stockholders of an old established, dividend paying corporation generally take less risk than the stockholders of a new firm which may or may not prove successful over a period of years. Both provide equity capital, but does each group also provide venture capital? Generally speaking venture capital should be used to refer to those contributions of stockholders or owners which are being used in a business or industry in which there is a large element of risk. The stockholder is willing to "venture" or put his funds into business because he hopes to realize a large profit or return in the end. As one commentator said, "Venture capital has to break its path on an untrodden economic frontier."

There is a tendency, in some cases, to use the term "venture or risk capital" to refer to all types of investments in which the investors take a high risk regardless of whether the investors are buying common or preferred shares, or bonds or debentures. Again it is frequently implied that venture capital refers especially to the contributions made toward the creation or establishment of a new and untried business. Evidently this inference is not too convincing for the reason that some of the older firms which need additional capital, present a greater risk

than some new, small enterprise. This may be especially true in the case of reorganization of a business. From this discussion it must be clear that there is not a general agreement as to the meaning of venture capital. What we may fairly safely assume is that it refers to capital investments in which there is a high risk.

SOURCES OF EQUITY FUNDS

One of the basic problems facing business enterprises—both small and large—is that of obtaining an adequate supply of permanent capital or equity funds. This problem exists both with regard to new businesses and to a large number of individuals, firms and corporations which have been in operation for many years. The question is especially disturbing to small or medium sized concerns.

The sources of funds vary from small to larger enterprises and from one industry to another. Equity capital represents the original investment in the firm plus additions to the capital funds for expansion. Large corporations obtain additional funds from retained net profits and from the sale of securities (stocks and/or bonds) in the capital market. Small concerns have been forced in the past to rely very largely on retained earnings for capital expansion. Small firms are practically excluded from the security markets. Some funds may be had from friends or relatives of the managers of small business organizations or other private investors, but the volume of such funds in the aggregate is not very important. The various sources of equity funds may be grouped as follows:

Small business generally acquires equity capital from:

1. entrepreneur himself
2. friends and relatives
3. other business concerns
4. local investors and capitalists
5. the security markets
6. retained earnings

Large enterprises acquire equity funds from:

1. entrepreneurs or original stockholders
2. security markets—stocks and bonds
3. retained earnings

Retained earnings have long been an important source of additional capital. They afforded intelligent, capable management a means for obtaining funds needed for expanding the business. They have made

it possible for many small businesses to grow and become medium sized or even larger. High tax rates have cut deeply into the earnings of small business enterprises. It is now difficult to retain sufficient earnings to expand. In addition, the high tax rates applicable to personal incomes have made it difficult for young executives to accumulate sufficient funds through savings to buy up and own a small business once the old management may wish to retire. Retained earning in the past have been an important source for expanding small businesses. The high tax rate now renders this method quite ineffective in many cases.

The number of new firms started each year is a broad indication of the demand which will likely be made for funds by small concerns. It is important that a large number of new firms come into existence each year. The amount of funds needed by new firms, while large in aggregate, perhaps, is not as large as the number of such concerns might indicate. The new firms are, for the most part, small service or retail organizations with few, if any, employees. Individually they do a very small volume of business; hence most of them will never ask for any substantial amount of either equity funds or commercial credit. Proprietors of small trade and retail businesses must rely largely upon their own funds plus the limited amounts which friends and relatives may contribute.

What are the primary reasons why there is shortage of venture or equity capital? Investors and savers need a favorable climate in which to invest their funds. Until recent years there has been a steady stream of savings going from individual savers as well as from corporate earnings into new plant and equipment. The opportunities were sufficient to attract the funds. At the present time there is reported to be a dearth of new private savings. It is reported that the "majority of people with savings are more desirous of security for their savings than they are for large profits from new ventures, or even from old ventures." They are, therefore, investing most of their savings in government bonds, in life insurance policies, and in savings banks.

REASONS FOR A SHORTAGE OF EQUITY FUNDS

The following factors have tended to restrict the supply of equity funds for all types of businesses.

1. High taxes have cut deeply into the income of those with relatively high incomes. This is significant because it is this group which has supplied in the past a large share of venture capital. Heavy taxes make it especially difficult for small firms to build up equity funds through retained earnings.

High taxes have reduced the amount available for investment. They reduced the amount which the investor may hope to realize from future investments since the opportunity for profits or interest is greatly reduced by high taxes on future earnings. It is not possible to plow back such large amounts in the form of earnings, hence the possibility of growth is greatly lessened for the years ahead. The risk is also increased to the investor since the margin of profit has been reduced.

2. Increasing wage rates have made it more difficult for many concerns, both small and large, to make ends meet.

3. Strikes have, in many instances, reduced the possibility of making satisfactory profits. Reduced or complete cessation of operations for a time reduced the output. This, in turn, reduced profits and lessened the desire of some investors to participate.

4. Deep distrust of the socialistic trends. Many fear that it will be only a matter of time until the government will impose more severe restrictions on business which will be followed by greater participation by the government with less and less opportunity to make a profit. The tendency of many investors to seek security has increased the demand for bonds rather than stocks.

5. The spread of pension plans adds additional fixed charges to industry, which, unless accompanied by higher prices or increased productivity, means lower net earnings.

The failure to obtain equity funds has induced many small firms to seek credit from banks. Many have made efforts to obtain long-term loans from banks. In this some have not succeeded. The reason for failure has been due to different factors. Some bankers refuse to make long-term loans. They emphasize the need for liquidity in some cases. In other cases there is a shortage of collateral. In many cases the small business enterprise is just not a good credit risk from the point of view of the bank. The credit rating is too low and the risk too high to obtain the credit needed. In other cases the applicant is told that additional equity capital is needed, not loans.

The cost of making and keeping track of small loans is high—frequently the prevailing interest rates are too low to cover the costs involved. The large number of failures among small businesses make uncertain the future of small business. Continuity is essential if long-term or mortgage credit is to be extended. Despite the problems involved commercial banks have for a long time been quite willing to make loans.

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With regard to raising capital funds through the sale of common

and preferred stock, the two main obstacles encountered were business uncertainty, and the fact that many of those who might go to the security markets are either new or small concerns which cannot obtain funds from that source. These conditions apply either to the sale of common or preferred stock. There is essentially no difference in the suggested obstacles to be overcome in the sale and distribution of common and preferred shares. The difficulties of raising funds through the sale of bonds or mortgages correspond more nearly to those encountered in the sale of stock than to those involved in the raising of funds through commercial loans.

The risk is great not only with regard to new business, but also with regard to many small, old firms. Aside from the risk there is the fact that such securities are generally unmarketable, such investments would become "illiquid" or "frozen" once they had been made. The number of failures or discontinuances are relatively high in the case of small firms—both old and new.

ARE METHODS OF FINANCING SMALL BUSINESS CHANGING BASICALLY?

A fairly substantial group of businessmen holds that business practices have been changing so rapidly and fundamentally in recent years that new methods of financing are required to meet new developments. Another argument that has been advanced is that commercial banks have not provided sufficient funds to meet the essential needs of small business, consequently new institutions should be established to finance properly business under these new conditions. This general attitude is further emphasized by the recent demands that government either guarantee the loans of small business enterprises or advance funds to them directly. Provisions for guaranteeing loans were embodied in the sections of the Small Business Bill of 1950 which provided for the creation of national investment companies.

46.

HOW TO READ A FINANCIAL REPORT

START A CONVERSATION about the Federal budget, your income tax return or the latest General Motors report and four people out of five will throw up their hands in horror. "All those figures just make my head swim," one will say, while at least a couple will plead that since they squeezed through high school algebra they have put higher mathemathics behind them. The other may give vent to violently uncomplimentary remarks about the whole business of figures and finance.

Inquire a little further, however, and you'll very likely find that at least two out of five are investors. It may well be that they all are!

Are balance sheets really as difficult as all that? Well, if you know they are not so difficult because you have worked with them before, this book is not written for you. However, if you find financial statements a bit murky, but realize their great importance to you, we ought to get along fine together. For "mathematics" all we'll use is fourth grade arithmetic.

Accountants, like all other professional men, have developed a specialized vocabulary. Sometimes this is helpful and sometimes plain confusing (like their practice of calling the income account "Statement of Profit and Loss" when it is bound to be one or the other). But there are really only a score or so technical terms that you will have to get straight in mind. After that is done the whole foggy business will begin to clear and in no time at all you'll be able to talk as wisely as the next fellow. More important still, you'll be much better fitted to "investigate *then* invest."

The accompanying report is neither the simplest that could be issued, nor the most complicated. It is a good average sample of the kind of report issued by an up-to-date manufacturing company.

Note particularly that the *balance sheet* represents the situation

CONSOLIDATED BALANCE SHEET—DECEMBER 31, 1946

ASSETS

ITEM			
1.	CURRENT ASSETS:		
2.	Cash		$ 2,000,000
3.	U. S. Government Securities		1,000,000
4.	Accounts Receivable (less reserves)		2,000,000
5.	Inventories (at lower of cost or market)		2,000,000
6.	TOTAL CURRENT ASSETS		$ 7,000,000
7.	INVESTMENT IN AFFILIATED COMPANY—Not consolidated (at cost, not in excess of net assets)		200,000
8.	OTHER INVESTMENTS—AT COST, less than market		100,000
9.	PLANT IMPROVEMENT FUND		550,000
10.	PROPERTY, PLANT AND EQUIPMENT: Cost	$8,000,000	
11.	Less Reserve for Depreciation	5,000,000	
12.	NET PROPERTY		$ 3,000,000
13.	PREPAYMENTS		50,000
14.	DEFERRED CHARGES		100,000
15.	PATENTS AND GOODWILL		100,000
	TOTAL		11,100,000

THE TYPICAL MANUFACTURING COMPANY, INC.

LIABILITIES

ITEM			
16.	CURRENT LIABILITIES:		
17.	Accounts Payable		$ 300,000
18.	Accrued Taxes		800,000
19.	Accrued Wages, Interest and other Expenses		370,000
20.	TOTAL CURRENT LIABILITIES		$ 1,470,000
21.	FIRST MORTGAGE SINKING FUND BONDS, 3½% DUE 1966		2,000,000
22.	RESERVE FOR CONTINGENCIES		200,000
23.	CAPITAL STOCK:		
24.	5% Preferred Stock (authorized and issued 10,000 shares of $100 par value)	$1,100,000	
25.	Common Stock (authorized and issued 400,000 shares of no par value)	1,000,000	2,000,000
26.	SURPLUS:		
27.	Earned	$3,530,000	
28.	Capital (arising from sale of common capital stock at price in excess of stated value)	1,900,000	5,430,000
	TOTAL		$11,100,000

as it stood on one particular day, December 31, 1946, not the record of a year's operation. This balance sheet is broken into two parts; on the left are shown *"Assets"* and on the right *"Liabilities."* Under the asset column you will find listed the value of things the company *owns* or are *owed to* the company. Under liabilities, are listed the things the company owes to others, *plus* reserves, surplus and the stated value of the stockholders' interest in the company.

One frequently hears the comment, "Well, I don't see what good a balance sheet is anyway, because the assets and liabilities are always the same whether the company is successful or not."

It is true that they always balance and, by itself, a balance sheet doesn't tell much until it is analyzed. Fortunately, we can make a balance sheet tell its story without too much effort—often an extremely revealing story, particularly if we compare the records of several years.

ASSETS

The first notation on the asset side of the balance sheet is *"Current Assets"* (item 1). In general, current assets include cash and things that can be turned into cash in a hurry, or that in the normal course of business will be turned into cash in the reasonably near future, usually within a year.

Item 2 on our sample sheet is *"Cash."* Cash is just what you would expect—bills and silver in the till and money on deposit in the bank.

"United States Government Securities," is item 3. The general practice is to show securities listed as current assets at cost or market value, whichever is lower. The figure, for all reasonable purposes, represents the amount by which total cash could be easily increased if the company wanted to sell these securities.

The next entry is *"Accounts Receivable"* (item 4). Here we find the total amount of money owed to the company by its regular business creditors and collectible within the next year. Most of the money is owed to the company by its customers for goods that the company delivered on credit. If this were a department store instead of a manufacturer, what you owed the store on your charge account would be included here. Because some people fail to pay their bills, the company sets up a reserve for doubtful accounts which it subtracts from *all* the money owed.

Item 5, *"Inventories,"* is the value the company places on the supplies it owns. The inventory of a manufacturer may contain raw materials that it uses in making the things it sells, partially finished goods in process of manufacture and, finally, completed merchandise

that is ready to sell. Several methods are used to arrive at the value placed on these various items. The most common is to value them at their cost or present market value, whichever is lower. You can be reasonably confident, however, that the figure given is an honest and significant one for the particular industry if the report is certified by a reputable firm of public accountants.

Next on the asset side is *"Total Current Assets"* (item 6). This is an extremely important figure when used in connection with other items in the report, which we will come to presently. Then we will discover how to make total current assets tell their story.

"Investment in Affiliated Company" (item 7) represents the cost to our parent company of the capital stock of its *subsidiary* or affiliated company. A subsidiary is simply one company that is controlled by another. Most corporations that own other companies outright, lump the figures in a *"Consolidated Balance Sheet."* This means that under cash, for example, one would find a total figure that represented all of the cash of the parent company and of its wholly owned subsidiary. This is a perfectly reasonable procedure because, in the last analysis, all of the money is controlled by the same persons.

Our typical company shows that it has *"Other Investments"* (item 8), in addition to its affiliated company. Sometimes good marketable securities other than Government bonds are carried as current assets, but the more conservative practice is to list these other security holdings separately. If they have been bought as a permanent investment they would always be shown by themselves. "At cost, less than market" means that our company paid $100,000 for these other investments, but they are now worth more.

Among our assets is a *"Plant Improvement Fund"* (item 9). Of course, this item does not appear in all company balance sheets, but is typical of *special funds* that companies set up for one purpose or another. For example, money set aside to pay off part of the bonded debt of a company might be segregated into a special fund. The money our directors have put aside to improve the plant would often be invested in Government bonds.

FIXED ASSETS

The next item (10) is *"Property, Plant and Equipment,"* but it might just as well be labeled "Fixed Assets" as these terms are used more or less interchangeably. Under item 10 the report gives the value of land, buildings and machinery and such movable things as trucks, furniture and hand tools. Historically, probably more sins were committed against this balance sheet item than any other.

In olden days, cattlemen used to drive their stock to market in the city. It was a common trick to stop outside of town, spread out some salt for the cattle to make them thirsty and then let them drink all the water they could hold. When they were weighed for sale the cattlemen would collect cash for the water the stock had drunk. Business buccaneers, taking the cue from their farmer friends, would often "write up" the value of their fixed assets. In other words, they would increase the value shown on the balance sheet, making the capital stock appear to be worth a lot more than it was. *"Watered Stock"* proved a bad investment for most stockholders. The practice has, fortunately, been stopped, though it took major financial reorganizations to squeeze the water out of some securities.

The most common practice today is to list fixed assets at cost. Often, there is no ready market for most of the things that fall under this heading, so it is not possible to give market value. A good report will tell what is included under fixed assets and how it has been valued. If the value has been increased by "write-up" or decreased by "write-down," a footnote explanation is usually given. A *"write-up"* might occur, for instance, if the value of real estate increased substantially. A *"write-down"* might follow the invention of a new machine that put an important part of the company's equipment out of date.

DEPRECIATION

Naturally, all of the fixed property of a company will wear out in time (except, of course, non-agricultural land). In recognition of this fact, companies set up a *"Reserve for Depreciation"* (item 11). If a truck costs $4,000 and is expected to last four years, it will be depreciated at the rate of $1,000 a year.

Two other terms also frequently occur in connection with depreciation—"depletion" and "obsolescence." Companies may lump depreciation, depletion and obsolescence under a single title, or list them separately.

"Depletion" is a term used primarily by mining and oil companies (or any of the so-called extractive industries). Depletion means exhaust or use up. As the oil or other natural resource is used up, a reserve is set up to compensate for the natural wealth the company no longer owns. This reserve is set up in recognition of the fact that as the company sells its natural product it must get back not only the cost of extracting, but also the orginal cost of the natural resource.

"Obsolescence" represents the loss in value because a piece of property has gone out of date before it wore out. Airplanes are modern examples of assets that tend to get behind the times long before the parts wear out. (Women and husbands will be familiar with the speed at which ladies' hats "obsolesce.")

In our sample balance sheet we have placed the reserve for depreciation under fixed assets and then subtracted, giving us *"Net Property"* (item 12), which we add into the asset column. Sometimes, companies put the reserve for depreciation in the liability column. As you can see, the effect is just the same whether it is subtracted from assets or added to liabilities.

The manufacturer whose balance sheet we use rents a New York showroom and pays his rent yearly, in advance. Consequently, he has listed under assets *"Prepayments"* (item 13). This is listed as an asset because he has paid for the use of the showroom, but has not yet received the benefit from its use. The use is something coming to the firm in the following year and, hence, is an asset. The dollar value of this asset will decrease by one-twelfth each month during the coming year.

"Deferred Charges" (item 14) represents a type of expenditure similar to prepayment. For example, our manufacturer brought out a new product last year, spending $100,000 introducing it to the market. As the benefit from this expenditure will be returned over months or even years to come, the manufacturer did not think it reasonable to charge the full expenditure against costs during 1946. He has "deferred" the charges and will write them off gradually.

INTANGIBLES

The last entry in our asset column is *"Patents and Goodwill"* (item 15). If our company was a young one, set up to manufacture some new patented product, it would probably carry its patents at a substantial figure. In fact, "intangibles" of both old and new companies are often of great but generally unmeasurable worth.

Company practice varies considerably in assigning value to intangibles. Proctor & Gamble, despite the tremendous goodwill that has been built up for "Ivory Soap," has reduced all of its intangibles to the nominal $1. Some of the big cigarette companies, on the contrary, place a high dollar value on the goodwill their brand names enjoy. Companies that spend a lot for research and the development of new products are more inclined than others to reflect this fact in the value assigned to patents, license agreements, etc.

LIABILITIES

The liability side of the balance sheet is a little tricky at first glance. Several of the entries simply don't sound like liabilities by any ordinary definition of the term.

The first item on the liability side of any balance sheet is usually *"Current Liabilities"* (item 16). This is a companion to the "Current Assets" item across the page and includes all debts that fall due within the next year. The relation between current assets and current liabilities is one of the most revealing things to be gotten from the balance sheet, but we will go into that quite thoroughly later on.

"Accounts Payable" (item 17) represents the money that the company owes to its ordinary business creditors—unpaid bills for materials, supplies, insurance and the like. Many companies itemize the money they owe in a much more detailed fashion than we have done, but, as you will see, the totals are the most interesting thing to us.

Item 18, *"Accrued Taxes,"* is the tax bill that the company estimates it still owes for the past year, 1946. We have lumped all taxes in our balance sheet, as many companies do. However, sometimes you will find each type of tax given separately. If the detailed procedure is followed, the description of the tax is usually quite sufficient to identify the separate item.

Accounts Payable was defined as the money the company owed to its regular business creditors. The company also owes, on any given day, wages to its own employees; interest to its bondholders and to banks from which it may have borrowed money; fees to its attorneys; pensions, etc. These are all totaled under *"Accrued Wages, Interest and Other Expenses"* (item 19).

"Total Current Liabilities" (item 20) is just the sum of everything that the company owed on December 31 and which must be paid sometime in the next twelve months.

It is quite clear that all of the things discussed above are liabilities. The rest of the entries on the liability side of the balance sheet, however, do not seem at first glance to be liabilities.

Our balance sheet shows that the company, on December 31, had \$2,000,000 of 3½ per cent First Mortgage *Bonds* outstanding (item 21). Legally, the money received by a company when it sells bonds is considered a loan to the company. Therefore, it is obvious that the company owes to the bondholders an amount equal to the face value or the *"call price"* of the bonds it has outstanding. The call price is a figure usually larger than the face value of the bonds at which price the company can "call" the bonds in from the bondholders and pay

them off before they ordinarily fall due. The date that often occurs as part of the name of a bond is the date at which the company has promised to pay off the loan from the bondholders.

RESERVES

The next heading, *"Reserve for Contingencies"* (item 22), sounds more like an asset than a liability. "My reserves," you might say, "are dollars in the bank and dollars in the bank are assets."

No one would deny that you have something there. In fact, the corporation treasurer also has his reserve for contingencies balanced by either cash or some kind of unspecified investment on the asset side of the ledger. His reason for setting up a reserve on the liability side of the balance sheet is a precaution against making his financial position seem better than it is. He decided that the company might have to pay out this money during the coming year if certain things happen. If he did not set up the "reserve" his surplus would appear larger by an amount equal to his reserve.

A very large reserve for contingencies or a sharp increase in this figure from the previous year should be examined closely by the investor. Often in the past companies tried to hide their true earnings by transferring funds into a contingency reserve. As a reserve looks somewhat like a true liability, stockholders were confused about the real value of their securities. When a reserve is not set up for protection against some very probable loss or expenditure it should be considered by the investor as part of surplus.

CAPITAL STOCK

Below reserves there is a major heading: *"Capital Stock"* (item 23). Companies may have one type of security outstanding, or they may have a dozen. All of the issues that represent shares of ownership are capital, regardless of what they are called on the balance sheet—preferred stock, preference stock, common stock, founders' shares, capital stock, or something else.

Our typical company has one issue of 5 per cent *"Preferred Stock"* (item 24). It is called "preferred" because those who own it have a right to dividends and assets before the "common" stockholders—that is, the holders are in a preferred position as owners. Usually preferred stockholders do not have a voice in company affairs unless the company fails to pay them dividends at the promised rate. Their rights to dividends are almost always "cumulative." This simply means that all past dividends must be paid before the other stockholders can receive anything.

Preferred stockholders are not creditors of the company so it cannot properly be said that the company "owes" them the value of their holdings. However, in case the company decided to go out of business, preferred stockholders would have a prior claim on anything that was left in the company treasury after all of the creditors, including the bondholders, were paid off. In practice, this right does not always mean much, but it does explain why the book value of their holdings is carried as a liability.

"Common Stock" (item 25) is simple enough as far as definition is concerned—it represents the rights of the ordinary owner of the company. Each company has as many owners as it has stockholders. The proportion of the company that each stockholder owns is determined by the number of shares he has. However, neither the book value of a no-par common stock, nor the par value of an issue that has a given par, can be considered as representing either the original sale price, the market value or what would be left for the stockholders if the company were liquidated.

A profitable company would seldom be dissolved. Once things have taken such a turn that dissolution appears desirable, the stated value of the stock is generally nothing but a fiction. Even if the company is profitable as a going institution, once it ceases to function even its tangible assets drop in value because there is not usually a ready market for its inventory of raw materials and semi-finished goods, or its plant and machinery.

SURPLUS

The last major heading on the liability side of the balance sheet is *"Surplus"* (item 26). The surplus, of course, is not a liability in the popular sense at all. It represents, on our balance sheet, the difference between the stated value of our common stock and the net assets behind the stock.

Two different kinds of surplus frequently appear on company balance sheets and our company has both kinds. The first type listed is *"Earned"* surplus (item 27). Earned surplus is roughly similar to your own savings. To the corporation, earned surplus is that part of net income which has not been paid to stockholders as dividends. It still "belongs" to the stockholders just as your savings account belongs to you, but the directors have decided that it is best for the company and the stockholders to keep it in the business. The surplus may be invested in the plant just as you might invest part of your savings in your home. It may also be in cash or securities.

In addition to the earned surplus, our company also has a *"Capital" surplus* (item 28), of $1,900,000, which the balance sheet explains arose from selling the stock at a higher cost per share than is given as its stated value. A little arithmetic shows that the stock is carried on the books at $2.50 a share while the capital surplus amounts to $4.75 a share. From this we know that the company actually received an average of $7.25 net a share for the stock when it was sold.

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THE OVER-THE-COUNTER MARKET

JOHN C. LOESER

IN SCORES OF FINANCIAL COMMUNITIES throughout the United States there are houses that are known as "dealers" in investment securities. The advertisements through which the various houses address themselves to the investing public are familiar insertions in the pages of the financial press. Usually such advertisements are mere notices announcing the houses to be, for instance, "Dealers in Railroad, Public Utility and Industrial Bonds" or "Dealers in United States Government Securities" or "Dealers in State and Municipal Bonds" or "Dealers in Stocks and Bonds." The announcements are sometimes even more brief, often just "Investment Securities."

In the formal, conservative phrasing of the advertisements that the financial houses use to invite the public to do business with them there is little to suggest the importance of the functions they perform or of the services they render in the financial and economic life of the nation. Yet, financial houses like these create and maintain a market for securities separate and apart from those maintained on

the floors of the securities exchanges and the volume of purchases and sales of securities that they transact in this market in the course of a year is estimated in billions of dollars. Such is the importance in the nation's financial and economic organization of the financial houses—some 6,700 of them with about 2,300 branch offices throughout the country—that create and maintain what has come to be known as the over-the-counter market for securities.

The over-the-counter market is a trading market for many thousands of issues of bonds and stocks. It is the principal market for "governments," as the obligations issued by the United States government and its various incorporated agencies and instrumentalities are termed. It is the sole market for the obligations issued by the states, cities, counties and other political and tax subdivisions, securities which as a class are known as "municipals." It is a market for numerous issues of bonds and stocks of the railroads, public utilities and industrial companies, of shares of the banks, trust companies and insurance companies, of foreign as well as American securities. It is a market in which investors of all classes—commercial banks, savings banks, trust companies, insurance companies, corporations and other institutional buyers and sellers of securities as well as individuals—buy and sell investment securities.

The market over the counter is a market not only for the buying and selling of outstanding issues of bonds and stocks but for the sale and distribution of new issues of securities. Practically all the primary distribution—the initial placing with investors—of new corporation, municipal and foreign security issues takes place in the over-the-counter market.

WHAT IS A "DEALER"?

The financial houses that create and maintain the over-the-counter market are of two major types. First, there are those which are known by the general term of "securities houses" and second, there are those banks which are spoken of as "dealer banks" because, in addition to performing their regular banking functions, they engage in the business of dealing in securities, although by law they are limited to dealing solely in United States government and municipal issues.

The securities houses are usually called "dealers" but often they are referred to technically as "broker-dealers" inasmuch as most of them at times act as "brokers." Some of the houses act solely as brokers in the over-the-counter market but with these exceptions the houses and the dealer banks that create and maintain this market usually act primarily as dealers.

When a house buys or sells a security for a customer as a broker it is the agent of the customer for whom it is acting and it goes into the market and makes the purchase or sale for the account and risk of the customer, charging a commission for the service it renders in executing the order. But the function of a dealer is quite different. A dealer house buys and sells not as an agent, like the broker, but as a principal for its own account and risk. It buys directly from those who come to it with securities to sell and it sells securities directly to those who come to it wanting to buy. Thus a house acting as a dealer buys securities in outright purchase and acquires ownership of the securities, and it sells securities in outright sale, delivering securities in which it actually has ownership.

"CREATING AND MAINTAINING A MARKET"

A dealer engages in "creating and maintaining a market" for securities. A house "creates" a market for a security when it is prepared both to buy and to sell that security at the prices it quotes, and it "maintains" such a market when it continues over a period to quote the prices at which it is ready both to buy and to sell.

When a house stands ready, for instance, to buy American National Railway 4% Bonds of 1959 (a purely fictitious issue cited solely for illustration) from those who come to it with those bonds to sell and at the same time to sell American National Railway 4% Bonds of 1959 to those who come to it wanting to buy them, the house is providing a market for that security issue because it is prepared both to buy from sellers and to sell to buyers. In the language of finance the house is said to be "creating and maintaining a market" or, colloquially, "making a market," for American National Railway 4% Bonds of 1959.

What a house does when it creates and maintains a market for any issue of bonds or of stock is to announce openly to other dealer and broker houses that it stands ready both to buy and to sell that security by way of the bid price and the offering price that it quotes to those who inquire. A house may announce, for example, that it is making a market for American National Railway 4% Bonds of 1959 at "102¼ bid, offered at 102½," or, as it is usually expressed, just "102¼-102½." Here the house is saying that it will buy these bonds from sellers at 102¼, the price it is bidding for them, and will sell the bonds to buyers at 102½, the price at which it is offering them for sale. It quotes its "market," as the combined bid and offering price quotation is called, without knowing in advance whether the inquiring house intends to buy or to sell, and the option to do one or the other at the quoted

prices lies with the inquirer. Furthermore, these prices, unless otherwise specified at the time, are "firm," which means that the house is prepared actually to do business at the quoted prices.

ORIGIN OF THE TERM "OVER THE COUNTER"

The dealer in securities has played an outstanding role in the financial and economic development of the United States. There have always been commercial or financial houses of one kind or another that have acted as dealers in bonds and stocks. The first bonds issued by the federal government and the shares in the early banks, insurance companies and other corporations were dealt in by the early merchant houses and state-chartered banks of the post-Revolution period.

The term "over the counter," however, does not appear to have originated or come into general use until a century or so ago. Investors of that period were accustomed to make their purchases and sales of investment securities through the private banking houses which, as one of their regular activities, engaged in the business of buying and selling United States government, municipal and corporate bonds as dealers.

In their interior appearance, these houses were not unlike small commercial banks of today. There were counters such as are found in modern banking institutions and over these investors directly bought from and sold to the houses. It was over these counters that they actually paid for and accepted delivery of the securities they bought and delivered and accepted payment for the securities they sold. Hence, purchases and sales transacted by these dealer institutions came to be known as transactions "over the counters" to distinguish them from those effected by public auction on the "stock and exchange boards," as exchanges were then called. The present securities houses and banks that act as dealers are the successors to the trading function of the earlier private bankers and the market which they create and maintain separate and apart from the exchanges has thus become known as the over-the-counter market.

Fundamentally there is little essential difference in the manner in which investors of a century ago transacted business with the private bankers and those of the present do business with today's over-the-counter dealers. Just as investors bought and sold securities over the counters of the private banking houses, so today such investors as the banks, insurance companies and other institutions as well as individuals, approach the over-the-counter dealers and directly buy securities from them and sell securities to them.

TYPES OF DEALERS

The securities houses that act as dealers or brokers in the over-the-counter market are far more numerous than the dealer banks and more diverse in type. As a group they comprise houses that are known more commonly by terms descriptive of their major specialized activity within the broader field of finance. They include investment banking houses, over-the-counter houses, municipal bond dealers, government bond dealers and also exchange member firms which operate over-the-counter trading departments. Although many engage in various other activities of a financial character these houses perform a common function in that they act as dealers or brokers in the over-the-counter market and with the dealer banks create and maintain that market. Each of the various types of these broker-dealer organizations is briefly described here.

Investment Banking Houses. The principal function of investment bankers is to provide capital for business and industry by means of the public sale and distribution of securities. Their prominence in the originating, underwriting and distributing of new issues of securities has led these houses to be identified chiefly with the function of security distribution rather than of security trading. Although generally their interests are directed principally to the financing of corporate enterprises, not infrequently some of them purchase or participate with others in the purchase of new issues of municipal securities for distribution among investors. The investment banking houses are an important factor in the over-the-counter market not only because many of them have trading departments through which they deal in outstanding bonds and stocks but because of their activity in the primary distribution of new issues of corporate, municipal and other securities among the public.

Over-the-Counter Houses. These financial houses do not engage to any important extent in performing the investment banking function, they hold no memberships on exchanges, and while on occasion they buy or sell municipal or United States government securities they do not engage as a general practice in trading them. They engage solely or chiefly in both buying and selling corporation bonds and stocks or foreign securities as dealers or brokers and in creating and maintaining a market for such securities. Because they act as dealers or brokers mainly in the over-the-counter market they have come to be known as "over-the-counter houses."

Municipal Bond Houses. These are houses that specialize in buying and selling the obligations issued by the states, cities, counties,

and other political and tax subdivisions. In the main they are neither investment bankers for business and industry nor members of securities exchanges. They engage solely or chiefly in trading outstanding municipal issues and, for the most part, they buy or participate with other houses or with banks in buying new issues of municipal securities directly from the issuers, customarily at public bidding, and distribute these securities among investors. With dealer banks and with other houses that deal secondarily in municipal issues they create and maintain a market for municipal securities of all kinds and in a general way they perform somewhat the same financing service for states and municipalities and other local governmental divisions that investment banking houses render for corporations and for foreign issuers.

Government Bond Houses. A number of houses in the more important financial communities specialize in dealing in the obligations issued by the United States government and its various incorporated agencies and instrumentalities. These bond dealers, together with dealer banks, create and maintain the over-the-counter market for government issues. "Government houses," as these organizations are colloquially termed, as a general rule also act as dealers in corporation and other securities.

Exchange Member Houses. Many firms that hold memberships on securities exchanges also engage in buying and selling bonds and stocks in the over-the-counter market as dealers or brokers. Usually these exchange member firms have special over-the-counter trading departments to handle this division of their business, which in some cases constitutes a large part of their gross volume.

Dealer Banks. A number of banks, principally the larger commercial banking institutions in the more important financial centers, act as dealers in United States government securities and municipal obligations, the only classes of securities in which the law permits them to engage in the business of acting as dealers. Usually these institutions have government bond and municipal bond departments to handle this trading business. When they engage in the business of buying and selling these securities as dealers the banks are competitors of the securities houses dealing in the same types of issues. But when they buy and sell railroad, public utility, industrial and other issues for their investment portfolios they, like the non-dealer banks, are customers of the securities houses. In common with the insurance companies and other institutional buyers and sellers of securities, banks usually transact their purchases and sales of securities for their investment portfolios directly with the dealers in the over-the-counter market.

SPECIALIZATION

In carrying out their market-making function it is usual for the houses to specialize as dealers in certain securities. As has been mentioned, the dealer banks act as dealers only in United States government and municipal securities. The government bond houses specialize in dealing in United States government securities while the municipal bond houses specialize in the securities of the states and other municipal issuers.

Among the municipal dealers specialization is carried to the point of dealing in issues within narrower fields. There are houses, for example, that specialize in dealing in the obligations issued by the larger and more important states and cities; others in the obligations of a single state and of municipal issuers within that state; others in the securities of several states and of political and tax subdivisions of those states.

In the field of corporation securities specialization tends in many different directions. Certain houses specialize in the shares of banks, trust companies and insurance companies, others in guaranteed railroad stocks, others in railroad bonds, public utility securities or industrial company issues. Within the industrial fields some houses specialize in the securities of companies within a particular industry as, for example, aviation, textile manufacturing, paper and pulp, chain store merchandising, sugar refining, personal finance, to cite only a few. Some houses make specialties of certain specific issues of securities that are not related to any particular industry, activity or group. Other houses specialize in securities of Canadian and other foreign issuers.

For the investor specialization presents no particular problems. In general, most houses transact business with customers in securities in which the houses themselves do not specialize. When an investor wants to buy or to sell a particular security it is not necessary to know which house or houses specialize in the issue. The house with which the investor regularly does business stands ready to serve him and to go directly to the specialist house and make the purchase or sale.

THE DEALER AS A SPECIALIST

As a result of the general practice of the dealer houses to specialize, the market over the counter has developed into one created and maintained to a great extent by specialists in the various issues regularly traded in the market. When a house specializes in certain particular security issues or in groups, types or classes of securities it is able to

concentrate its organization upon rendering highly developed services and facilities for trading those particular securities.

In respect to the securities in which it specializes, a house as a specialist creates and maintains primary markets for those securities and acts, as is sometimes said, as a "dealer's dealer." When a house regularly makes a market in a security issue other dealers and brokers in financial communities from coast to coast come to know that the house stands ready to buy and to sell that security. Hence, when other houses, wherever they may be, receive inquiries or orders to buy and to sell from their customers they generally go directly to a specialist house. A house that is known in the business to be a specialist in a certain security is a focal point to which buying and selling dealers and brokers go. As a result, from all directions inquiries and buying and selling orders converge to the specialist house and it becomes a meeting place of buying and selling interest in that issue—a center of supply and demand. Being a center of supply and demand the dealer serves as an intermediary between the two by buying from sellers and selling to buyers.

GEOGRAPHICAL DISTRIBUTION OF DEALERS

Securities houses or banks that act as dealers or brokers in the over-the-counter market are established in practically every financial community of consequence in the country. The broker-dealer houses, with the banks and other financial and fiduciary institutions, help to make up a financial community for they perform the essential function of furnishing facilities by which buyers and sellers of securities conveniently effect their purchases and sales and for this reason, among many others, they are a vital part of the nation's financial machinery.

New York is the principal financial center and it is only natural that the Wall Street district leads all other financial sections in the number of over-the-counter dealers and brokers. In this financial community there are more than 2,000 securities houses and banks that act as dealers or brokers in the over-the-counter market. But the financial communities of Chicago, Boston, Philadelphia and Los Angeles, San Francisco, Buffalo, Baltimore and Denver, Oklahoma City, Detroit and St. Louis, and more than a hundred other cities throughout the country are important centers of over-the-counter market trading. So widespread is the scope of the market that there is hardly a single state whose principal business and population centers are without a number of houses offering facilities for buying and selling securities over the counter.

48 · "LET THE BUYER BEWARE"

Glorious Opportunity to Get Rich Quick

Invest in
THE CALIFORNIA RANCHING COMPANY

Now being organized to start a cat ranch in California

We are starting a cat ranch in California with 100,000 cats. Each cat will average 12 kittens a year. The cat skins will sell for 30 cents each. One hundred men can skin 5,000 cats a day. We figure a daily net profit of over $10,000.

Now What Shall We Feeds the Cats?

We will start a rat ranch next door with 1,000,000 rats. The rats will breed twelve times faster than the cats. So we'll have rats to feed each day to each cat. Now what shall we feed the rats? We will feed the rats the carcasses of the cats after they have been skinned.

Now Get This

We feed the rats to the cats, and the cats to the rats, and get the cat skins for nothing. Shares are selling at 5 cents each, but the price will go up soon. Invest while opportunity knocks at your door.

THE CALIFORNIA RANCHING COMPANY.

[Beneath this poster (which appeared many years ago) as a warning in the bank window of the Guardian Savings and Trust Company of Cleveland, the following notice was displayed in large letters: SOME GULLIBLE PEOPLE WILL TRY TO BUY THIS STOCK. IT IS

A FOOLISH FAKE, OF COURSE, BUT NO MORE FOOLISH THAN MANY WILD-CAT SCHEMES BEING PROMOTED TODAY. INVESTIGATE BEFORE INVESTING. DON'T HAND YOUR MONEY OVER TO ANY UNKNOWN GLIB-TONGUED SALESMAN.]

49 ·

THE ECONOMIC VALUE OF SHORT SELLING

S. S. HUEBNER

In times of economic stress we hear strong criticism of short selling. As prices of grains recede, the tendency is to train the searchlight of public opinion upon this phase of our valuable commodity marketing system.

Much of the criticism of commodity short selling is ill-advised, and based on misconception. Thus law-making bodies are urged to take action helpful to the producer. Yet the records indicate clearly that laws unduly restricting futures markets are harmful, not helpful, to the farmer. Being injurious to the farmer, such laws are likewise a burden upon business and commerce in general.

Most everyone is in agreement on one point. The futures markets, with their hedging, or insurance, feature are of high value to the producer. By hedging, or insuring, grain holdings in the futures market it is possible for the buyer to pay the farmer more than would be possible without such insurance facilities. Being insured against the risk of wide price swings, the buyer of grain is able to work on a narrow margin as between producer and consumer. So the producer gets more, and the consumer pays less. And the danger of monopoly and the sins of secrecy are eliminated.

A trade in futures is the purchase or sale of a contract to receive or to deliver a certain amount of grain in a certain specified month. A hedging, or insurance, transaction is one made in the futures market to protect the holder of actual grain against price swings pending final disposition of such actual grain.

A short sale is the sale of a contract to deliver to the buyer during a specified month a certain amount of grain. The short-seller may or may not at the moment be in possession of the grain he has contracted to deliver. But bear this point in mind. For every bushel of grain sold short, the seller must buy back an equal amount. The short-seller may be a miller, a country elevator man, an exporter, manufacturer, or a trader who is seeking to anticipate the future price trend.

To have this highly desirable insurance feature of our commodity markets we must have both buying and short selling by those ever ready to assume the risks of price swings. The business man in the work of distributing our crops wishes to avoid speculative risks. He shifts such risks to the speculative element by means of hedging, or insuring.

If only the owners of actual grain were permitted to sell short, there would soon be an end to our futures markets. The reason is obvious. An insurance, or hedging, market must be broad and liquid. It must be continuous and able to instantly absorb large offerings. The purchases and sales of actual holders would not mesh at the precise time that trades were desired. But with a large speculative force ready at all times to assume the risks incident to ownership of a world commodity that is naturally subject to price variations, the insurance market functions smoothly and crops are evenly distributed over the world when free of attempts at artificial price stimulation.

To have hedging, or price insurance, there must be a futures market; to have a futures market there must be both long buying and short selling, with free play of the forces which register the composite opinion as to world supply and demand.

THE SERVICE OF TIME CONTRACTS

On organized exchanges commodities are sold on future delivery contracts, such as May or December wheat. Under the contract delivery must be made at the designated time and at the price agreed upon. Despite criticism, this practice is closely akin to modern business methods of, let us say, manufacturers, who accept orders long in advance of fulfillment and contract to deliver goods at a certain price.

Business men seek a trade profit. They avoid gambling. Yet after they have contracted for the future delivery of finished goods, a great

adverse change in raw material prices may wipe out a trade profit or even cause bankruptcy. Such price variations in grain, cotton and other raw materials are too dangerous for the business man. He turns to the futures market to insure against risk, and to shift the risk to those who make risk-bearing a business. The hazard confronting him is quickly eliminated through purchase of a futures contract, either from some commodity owner or equally responsible short-seller.

In this way the manufacturer arranges delivery of his raw material at designated future monthly delivery periods suitable for his purpose, at prices quoted at the time of purchase. These prices can be used in calculating the adequacy of the price offered him for the finished product. Reliance may be placed on these future contracts, as they are secured through the deposit of adequate funds, or margin, under exchange rules, to assure fulfillment.

NECESSITY OF HEDGING

Hedging, or price insurance, is the practice of making two contracts of an opposite though corresponding nature at practically the same time, one in the trade market, where the physical commodity is handled, and the other in the speculative market furnished by commodity exchanges.

A dealer in wheat, having purchased 10,000 bushels, may expect at best to make a gross trade profit of only a few cents a bushel in handling that grain. Yet a single day's price decline might wipe out his entire profit. He may be obliged to hold the grain for months. Millions upon millions of bushels must thus be held between harvest and consumption, in the face of records of vast price declines in a six or nine month period. What business man would welcome such risks, with the prospect of but a small trade profit, and when the original buying had been affected through loans? The fire hazard is small in comparison, and no sane business man would assume his own fire risks. Against the staggering risks of grain ownership there must be some means of insurance. And fortunately a fairly reliable method is now afforded by our speculative markets.

Immediately on buying the 10,000 bushels in the trade market, our grain dealer will offset the same with a short sale of an equal amount in the futures market, for delivery at some convenient future month. Henceforth, assuming a close relationship between prices in the futures and cash markets, the dealer is freed from the gamble of a severe price decline. He is always approximately even, whether the price rises or falls. If the price rises, he loses on the short sale what he makes on his actual holdings. But if the price declines, he makes on his short sale an amount equal to the loss suffered on the wheat he owns.

He is thus always substantially even as regards the wholesale price, no matter how low it may go, and to this he adds the customary trade profit of a few cents, which he seeks to earn through the physical handling of the wheat. He assures his trade profit and avoids the risk of loss on price swings.

When he sells the 10,000 bushels in the trade market to some buyer he also immediately covers his short sale in the futures market. Both contracts are entered into at the same time, and both terminated at the same time to avoid speculation. In some instances the trade transaction happens to be a short sale, in which case the hedging process is reversed: insurance is obtained in the futures market with the purchase of a futures contract.

Such a wholesome practice should not be condemned. It is a necessity for all who actually handle commodities as a trade proposition and are obliged to retain ownership for any period of time. It is clear that by reason of the practice middlemen can operate on a reasonably certain and therefore much smaller profit than would otherwise be possible, a factor beneficial to both producer and consumer. This is one of the outstanding services of all forms of insurance. The owner of a house could not afford to carry the fire risk himself for less than at least 5 per cent of the value for a year, and even then would be gambling. The tenant would be obliged to assume that heavy extra charge in his rent. But with fire insurance in existence, the cost of risk assumed by the owner does not exceed ¼ of 1 per cent in most communities.

Moreover, creditors find the practice of hedging highly beneficial. They are willing to grant a much larger volume of credit at more favorable rates of interest. Just as the banking world refers to "insured paper," so increasingly we see reference to "hedged paper." The analogy is complete. All insurance is fundamentally the same. It is "hedging." The owner of a $10,000 building hedges with a $10,000 insurance contract, and then proceeds to make his trade profit on the building, just as the distributor of grain seeks his trade profit and avoids speculative risks. I have often wondered whether, from the standpoint of public understanding, our commodity exchange business did not make a serious mistake in adopting the expression "hedging" instead of "insurance." The first term is rather mystifying to the public; the latter is generally understood. Japanese commodity exchanges have long used the terms "insurance purchases" and "insurance sales."

If you seek a full understanding of the intricate subject of our futures markets you must remember one all-important point. It is that the insurance, or hedging, institution comprises four essential factors. First, there must be a *short sale* in the form of a *futures contract.*

Next, the short sale must be made immediately—not the next hour. This, then, requires a free, *continuous market,* open and liquid, with small variations in price between successsive sales. And a continuous market is available only because of the existence of a *large group of traders,* risk takers, ever ready to buy and sell, thus guaranteeing quick market response to all demands. There must be free short selling and free buying.

Put an end to our grain, cotton and other organized exchanges, and it will follow inevitably that the marketing will soon be under some monopolistic system. The risk element would bring about the change, for capital is always unwilling to assume avoidable risk. Monopolies have their method of protecting capital against the hazard of price swings, just as commodity exchanges have theirs. A choice must be made. It is between risk bearing and risk elimination under a new monopolistic ownership system, and risk bearing and risk elimination under the present organized competitive system. The latter system controls the problem for its component competing interests. To every neutral student of the subject of commodity marketing it is clearly evident that freedom of the short sale is such an essential factor that its elimination would soon place the producer and the consumer at the mercy of a monopolistic system.

MODERN SPECULATIVE EXCHANGES

Organized futures exchanges in commodities constitute one of the great business institutions of the country. Again let me stress that few fundamental business institutions are so misunderstood by the public as are our commodity exchanges. In prosperous times, when the price of everything is reasonably high, complaints are rare. But every time business of all kinds is in the depths of an industrial convulsion (which occurs about every eight years), and prices of all things—including real estate, mineral products, stocks and bonds, and wholesale and retail prices of the multitudinous number of non-exchange commodities—are greatly depressed, the reading public is supplied with barrage after barrage against speculation and short selling on commodity exchanges.

It seems that a "goat" must be found upon which to affix the blame. Yet the factors which cause the stupendous liquidation in values during a business depression—whether represented on exchanges or not, and usually to a degree fully as great in values *not* determined on exchanges—are fundamentally economic and would exert the same influence irrespective of the existence of commodity exchanges.

Organized commodity markets are not responsible for the world

forces that cause our periodic economic "ups" and "downs." Speculation merely reflects the bearing of those fundamental factors upon values. It passes its collective judgment upon those factors and appraises them in the form of definite price quotations. The speculator, be he buyer or short-seller, is interested in the correctness of his judgment with respect to the future course of prices.

From a practical standpoint, speculators as a group are no doubt anxious to see prices higher rather than lower—at least sufficiently high to please the producing community—because they know that low prices mean endless trouble. The speculator, when entering upon his commitments, has no reason to prefer declining over rising prices. Either side of the market will furnish to him the same motivating force. His only problem is to appraise correctly the factors which govern the future movement of prices.

And let us always remember that price fluctuations, prior to 1850 when modern commodity exchanges were unknown, were just as severe and periodic abysmal declines just as great, if not greater, than now.

A CONTINUOUS MARKET

Let us consider the outstanding economic services of organized commodity exchanges. In the first place, the existence of a large group of trained traders, a sufficient number always ready to buy or sell, guarantees a continuous market to producers, distributors, creditors and ultimate buyers. Such a market enables buyers or sellers to obtain or to dispose of the commodity at any time, even in large quantities, and with rare exceptions at a price varying but slightly from the last previous quotation. Such a continuous market furnishes four outstanding advantages, as contrasted with the old order of things when commodity exchanges were unknown. Briefly stated, they are:

(1) It gives to the commodity the quality of liquidity. In other words, the commodity is practically synonymous with money. Because of the presence of a large speculative class, the commodity may be converted into cash at a moment's notice. Producers thus have the assurance that a sale may be affected at any time; dealers that their orders to sell may be promptly fulfilled through the purchase of the necessary quantity; and creditors that their loans, based upon the commodity as security, are sure of a repayment in the event that the collateral must be sold. With respect to the creditor group, the continuous market serves the purpose of *creditors' insurance*.

Enormous credit must be extended to move the nation's crops during the fall months, and to hold a goodly portion during the consum-

ing months. It is highly important that credit should be abundant and be guaranteed on the basis of the smallest possible margin as between current market value and the size of the loan. This the financial community is willing to grant because of the knowledge that, should circumstances require, the collateral may be promptly sold in a dependable market which fluctuates but slightly in the course of an hour or a day. The farmer, who wants cash, is thus given at all times the benefit of a prompt and efficient financing service. But the factor which gives this dependability to the creditor is the presence of an ever sufficient group of speculators to guarantee the continuous nature of the market upon which creditors place their reliance.

(2) There is assurance of a continuous price quotation service, publicly available to all interested parties. In view of the national and international nature of our grain and other commodity markets, and the enormous geographic distances between producers and dealers and between dealers and ultimate buyers, it is easy to imagine the amount of deception and fraud which would exist if transactions were private and buying and selling were unorganized. There would be about as many different prices as there are communities. But today commodity exchanges serve as clearing houses for all available information. They are united by wire communication, irrespective of distance, and are thus cognizant of the world's news. As already stated, speculation interprets this news into quotations with respect to both present and future deliveries. "Uninformed buyers," as I have stated elsewhere, "or those in the trade unable to acquire information regularly from widely scattered sources, are therefore protected in their purchases or sales by a large group of experts whose interpretation of news into current prices furnishes a degree of accuracy much greater than would be the case under a non-exchange system."

Quotations are given gratis to the public through the press and every means of far-flung publicity. There is thus protection against duplicity, sharp dealing, and gross inaccuracy. The humblest community and the humblest individual may easily ascertain the cost differential (consisting of transportation and other costs) between his locality and the central market where the quotations are made. Moreover, our exchanges also exercise every reasonable protection to safeguard their quotation service against improper use. They also apply to the whole market personnel a rigid and systematic control of business ethics and practices designed to do away with fraud and unfairness in personal dealings.

(3) Discounting the future through a free, continuous market gives reasonable assurance of the proper levelling of prices for the entire year,

thus avoiding unduly low prices during the fall months when the crops are moved. This is of the utmost importance to farmers. In the absence of a speculative system, harmonizing the present with the future, it is easy to imagine how low prices would invariably be in the fall when farmers are selling heavily, and how much higher, aside from the regular carrying charges, after the crop has been substantially sold. Circumstances may, of course, justify a change in price after the fall months. But in probably as many cases as otherwise, considering a long period of years, the best prices seem to have prevailed during the crop moving months rather than during the latter portion of the crop year.

(4) Speculation in a free, continuous market serves as a regulator of consumption. This is of the utmost importance to both farmers and consumers. Each year's crop should pertain essentially to itself, and should not materially overlap the next year's crop. Be the crop ever so small, it must be made to last the twelve months period. If, on the other hand, it proves unusually large, it should be essentially consumed within the year. Speculation constantly concerns itself with this important problem, and the rate of consumption is essentially bound up with the price of the commodity. In the event of a great shortage, a rise in price, all other factors being equal, will retard consumption and thus make the commodity last to the end of the season. But in the event of a bumper crop, a declining price will hasten consumption and substantially clean up surplus stocks by the time the next crop matures.

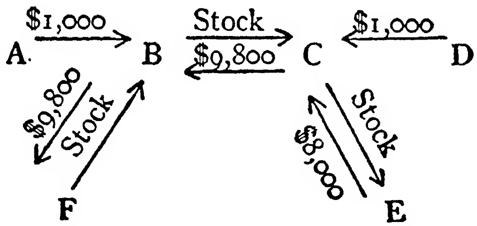
But for such regulation of consumption, however, we must have a free speculative market. To "peg" prices artificially high in any country, clearly out of line with the world prices, is bound to retard consumption, to lead to a vast unconsumed surplus, and to bring its aftermath of penalty with respect to the price of the new crop. We have only to view our recent experiences with a price pegged unduly high. A large unconsumed surplus inevitably resulted, to plague the farmer with a depressed price for the incoming crop.

The great need today is for free and open markets which constantly reflect supply and demand, which encourage speculative support, which place no more restrictions on short selling than on long buying, and which are free of attempts to artificially peg prices at levels unwarranted by basic conditions.

EXECUTING A SHORT SALE

CHARLES O. HARDY

THIS IS A SALE of stock which the customer does not own but which is borrowed for him by the broker for delivery, the loan being repaid when the stock is bought at a later date. The financing and executing of such transactions may be illustrated by the following diagram:



A and D are speculators, and B and C their respective brokers. A orders B to "sell short" for him 100 shares of Southern Pacific stock, posting about $1,000 as margin. B sells the 100 shares at $98 each to C, who represents D, a speculator desirous of purchasing 100 shares of Southern Pacific. D usually posts with C $1,000 as margin. Delivery and payment must be made the next day. In order to make delivery, B borrows 100 shares of Southern Pacific from F, posting with F the full $9,800 as security, and delivers the stock to C, collecting from him $9,800. C then posts the stock with E, a bank, as collateral for a loan of say, $8,000, advancing the balance out of his own funds.

Usually B collects from F interest on the $9,800, which is posted with him as collateral for the loan of the 100 shares of stock. D pays interest to C on his unpaid balance of $8,800 and C, of course, pays interest to E on the $8,000 which he has borrowed. Usually C and F pay the call loan rate, while D pays a customary rate which does not fluctuate as often as the call loan rate but averages somewhat higher. In case a dividend is declared on the stock while the short trade is open, both D and F are entitled to receive it. Hence A must make good one dividend, the company, of course, paying the other.

The advantage of the transaction to F is that he is enabled, through loaning his stock, to borrow on it up to 100 per cent of its face value; whereas through a bank he could probably not borrow more than 70 or 80 per cent. A may close out the transaction at any time by ordering B to purchase stock in the open market and deliver to F in repayment of the loan. D also may close out the trade at any time by ordering C to sell the stock in the open market. In case F desires the return of his stock before A wishes to purchase, it is B's business to borrow the stock elsewhere. In case the stock cannot be borrowed, B must "cover the sale," *i.e.,* buy the stock in for A's account. Most brokers will not execute orders for short sales except in securities which have a large floating supply, so that the risk of being compelled to "cover" in this way is small. In case of a scarcity of stock for loaning purposes, the interest rate paid by the lender of stock will go below the usual call rate. Sometimes the lender of stock is enabled to get the use of the money for nothing, in which case the stock is said to loan "flat" and occasionally a premium is paid for use of the stock in addition to the waiver of interest.

In practice, of course, C does not negotiate a separate loan at the bank for every margin trade his customers may make. What he does is to borrow on the mass of securities in his possession as much money as he needs to take care of his customers' demands. Most brokers carry their customers on smaller equities than do the banks, so that the broker has to advance part of the funds on his own capital. Some, however, pursue the opposite policy, requiring margins so large that they can secure larger loans from the bank than they make to their customers. The purpose of the margins is, of course, to protect the brokers against adverse fluctuations in the price of the stock. In the illustration above, if, while A is still short, the price of Southern Pacific advances, B must have some protection in his obligation to return the stock to F on demand. Even if he is not required to return the stock he may be called upon to post additional money for F's protection. In case the advance in prices is large, A will be called upon

to post additional margin, and if he is unable or unwilling to do so, the stock will be bought in the open market and delivered to F in repayment of the loan, and the loss charged to A's account. In case a sudden change of market makes it impossible for the broker to sell the stock at a price which protects him, or, in other words, in case the loss is greater than the margin A has posted, B has a valid claim against A for the additional loss. D's margin protects C against a decline in price just as A's margin protects B against advance.

PART THREE

Money and Banking

THE NATURE OF BARTER AND MONEY is explained by John T. Holdsworth in Article 51. W. Stanley Jevons' account of the early history of money constitutes Selection 52. Gresham's Law is stated in Selection 53, together with a similar statement *c.* 380 B.C. Number 54 is a statement on the braking power of the gold standard, by Walter E. Spahr. Number 55 consists of excerpts from a speech by William Jennings Bryan which swayed a previous generation in the gold-silver conflict. Number 56 is the text of the Joint Resolution voiding the gold clause. Number 57 gives the Supreme Court decision in *Perry v. United States,* in which the gold legislation of 1933–34 was subjected to judicial consideration. An eye-witness account of inflation in Germany in 1923 is found in Number 58, by William Philip Simms. Inflation during World Wars I and II is treated by Roy A. Foulke in Selection 59. Article 60 is a statement on inflation by a member of the Board of Governors of the Federal Reserve System, M. S. Szymczak. Number 61 is a statement of the obligations and privileges of banks in the Federal Reserve System. Rollin G. Thomas' analysis of the banker and credit instruments is given in Number 62. The Consumers' Price Index, so much in the news and underlying the cost-of-living clause in union contracts covering some three million workers, is explained in Number 63.

Other selections which might be read in connection with this Part are 70, 71, and 148.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged here.

(51) Holdsworth, J. T., *Money and Banking,* Appleton-Century-Crofts, 1917, pp. 4–5.

(52) Jevons, W. S., *Money and the Mechanism of Exchange,* Appleton-Century-Crofts, 1921, pp. 19–28.

(53) from R. L. Garis, *Principles of Money, Credit, and Banking,* Macmillan, 1934, pp. 69–70.

(54) Spahr, W. E., *The Case for the Gold Standard,* New York: Economists' National Committee on Monetary Policy, February 1940, pp. 15–16.

(55) Bryan, W. J., from an address before the Democratic National Convention, July 8, 1896.

(56) June 5, 1933 (48 Stat. 113).

(57) 294 U.S. 330, 55 S. Ct. 432, 79 L. Ed. 912 (1935).

(58) Simms, W. P., "Inflation in Germany," *The Pittsburgh Press,* 1923.

(59) Foulke, Roy, *Peaks and Valleys in Wholesale Prices and Business Failures,* New York: Dun & Bradstreet, 1950, pp. 21–26.

(60) Szymczak, M. S., *Federal Reserve Bulletin,* Government Printing Office, September, 1950.

(61) Board of Governors, *The Federal Reserve System,* Government Printing Office, 1947, pp. 49–50.

(62) Thomas, R. G., *Our Modern Banking and Monetary System,* Prentice-Hall, 1942, pp. 70–74.

(63) *The Consumer Price Index,* U. S. Department of Labor, Bureau of Labor Statistics. Explanation taken from releases of March 2, 1951, and May 23, 1951.

BARTER AND MONEY

JOHN T. HOLDSWORTH

BARTER:

Division of labor and exchange of goods have existed in some form from the beginning of organized society. In a very early stage people found by experience the advantage of each worker devoting himself to the production of certain things in which he was most skilled. The primitive fisherman whose preference or skill led him to follow fishing would often have a surplus of fish. Another man might be particularly adept in making spears, but as he did not need for his own use all that he could make he was glad to exchange his surplus for other things he needed, such as fish or skins.

This system of exchange, known as barter, was crude and clumsy. The man with a surplus of fish had to find someone with a surplus of spears or furs which he was willing to exchange for fish. Even then the terms of the trade were difficult to arrange. A spear was worth more than a fish, but it could not be divided; so to effect a trade the owner of the spear would be compelled to take more fish than he needed. Under a system of barter the difficulty increases with the number of articles to be exchanged. Without any common measure of value each trader would have to remember the value ratio between each article and all others offered in trade. Thus if he dealt in ten commodities he must remember forty-five ratios of exchange, but with a fixed standard of value only nine ratios would be involved.

MONEY:

In the course of time it appeared that among the numerous articles exchanged—shells, furs, grain, tobacco, or metals—there was one which

nearly everybody wanted. Gradually men recognized that, because of its beauty or utility or other quality, this commodity was the best thing to accept in exchange for what they had to sell, for it could be exchanged in turn for other products or services. In case of our Indian tribes, for example, shell beads were admired and prized by all. It is easy to understand how some members of the tribe might devote most of their time to hunting for the shells and making them into strings of beads which were in universal demand for personal adornment. A part of their stock of beads would be exchanged for food and other needs. A man who had a surplus of food would gladly exchange it for beads even though he had no particular desire for more beads. He would be better off with a surplus of beads than with a surplus of perishable food, for beads were always in demand. Thus, by unconscious selection, certain commodities came to be recognized as best fitted to serve the purpose of a go-between in making exchanges. In some such way the use of money began.

Exchange, then, may assume either of two forms: direct exchange, called barter, where commodities or services are directly exchanged one for the other; and indirect exchange by means of some article of general acceptability and convenient subdivision called money. Money is a commodity, to be sure, but when it is exchanged for other commodities or services the process is not called barter. We term this process buying and selling. It is an exchange of goods for goods by the use of an intermediary. Thus money represents an incomplete or suspended exchange. We willingly accept money for goods, not because the money itself gives us pleasure, but because we know we can exchange it in turn for the various things that will satisfy our wants. . . .

52

EARLY HISTORY OF MONEY

W. STANLEY JEVONS

LIVING IN CIVILIZED COMMUNITIES, and accustomed to the use of coined metallic money, we learn to identify money with gold and silver; hence spring hurtful and insidious fallacies. It is always useful, therefore, to be reminded of the truth, so well stated by Turgot, that every kind of merchandise has the two properties of measuring value and transferring value. It is entirely a question of degree what commodities will in any given state of society form the most convenient currency, and this truth will be best impressed upon us by a brief consideration of the very numerous things which have at one time or other been employed as money. . . .

CURRENCY IN THE HUNTING STATE

Perhaps the most rudimentary state of industry is that in which subsistence is gained by hunting wild animals. The proceeds of the chase would, in such a state, be the property of most generally recognized value. The meat of the animals captured would, indeed, be too perishable in nature to be hoarded or often exchanged; but it is otherwise with the skins, which, being preserved and valued for clothing, became one of the earliest materials of currency. Accordingly, there is abundant evidence that furs or skins were employed as money in many ancient nations. They serve this purpose to the present day in some parts of the world.

In the book of Job (ii. 4) we read, "Skin for skin, yea, all that a man hath will he give for his life"; a statement clearly implying that skins were taken as the representative of value among the ancient Oriental nations. Etymological research shows that the same may be

said of the northern nations from the earliest times. In the Esthonian language the word *raha* generally signifies money, but its equivalent in the kindred Lappish tongue has not yet altogether lost the original meaning of skin or fur. Leather money is said to have circulated in Russia as late as the reign of Peter the Great, and it is worthy of notice that classical writers have recorded traditions to the effect that the earliest currency used at Rome, Lacedaemon, and Carthage was formed of leather.

We need not go back, however, to such early times to study the use of rude currencies. In the traffic of the Hudson's Bay Company with the North American Indians, furs, in spite of their differences of quality and size, long formed the medium of exchange. It is very instructive, and corroborative of the previous evidence to find that, even after the use of coin had become common among the Indians, the skin was still commonly used as the money of account. Thus Whymper says, "A gun, nominally worth about forty shillings, bought twenty 'skins.' This term is the old one employed by the Company. One skin (beaver) is supposed to be worth two shillings, and it represents two marten, and so on. You heard a great deal about 'skins' at Fort Yukon, as the workmen were also charged for clothing, etc., in this way."

CURRENCY IN THE PASTORAL STATE

In the next higher stage of civilization, the pastoral state, sheep and cattle naturally form the most valuable and negotiable kind of property. They are easily transferable, convey themselves about, and can be kept for many years, so that they readily perform some of the functions of money.

We have abundance of evidence, traditional, written, and etymological, to show this. In the Homeric poems oxen are distinctly and repeatedly mentioned as the commodity in terms of which other objects are valued. The arms of Diomed are stated to be worth nine oxen, and are compared with those of Glaucos, worth one hundred. The tripod, the first prize for wrestlers in the 23rd Iliad, was valued at twelve oxen, and a woman captive, skilled in industry, at four. It is peculiarly interesting to find oxen thus used as the common measure of value, because from other passages it is probable, as already mentioned, that the precious metals, though as yet uncoined, were used as a store of value, and occasionally as a medium of exchange. The several functions of money were thus clearly performed by different commodities at this early period.

In several languages the name for money is identical with that of

some kind of cattle or domesticated animal. It is generally allowed that *pecunia,* the Latin word for money, is derived from *pecus,* cattle. From the *Agamemnon* of Aeschylus we learn that the figure of an ox was the sign first impressed upon coins, and the same is said to have been the case with the earliest issues of the Roman As. Numismatic researches fail to bear out these traditions, which were probably invented to explain the connection between the name of the coin and the animal. A corresponding connection between these notions may be detected in much more modern languages. Our common expression for the payment of a sum of money is *fee,* which is nothing but the Anglo-Saxon *feoh,* meaning alike money and cattle, a word cognate with the German *Vieh,* which still bears only the original meaning of cattle. As I am informed . . . the same connection of ideas is manifested in the Greek word for property . . . , which means alike possession, flock, or cattle, and is referred by Grimm to an original verb [meaning] to feed cattle. It is even supposed by Grimm that the same root reappears in the Teutonic and Scandinavian languages, in the Gothic *skatts,* the modern High German *schatz,* the Anglo-Saxon *scat,* or *sceat,* the ancient Norsk *skat,* all meaning wealth, property, treasure, tax, or tribute, especially in the shape of cattle. This theory is confirmed by the fact that the Frisian equivalent, *sket,* has retained the original meaning of cattle to the present day. In the Norsk, Anglo-Saxon, and English, *scat* or *scot* has been specialized to denote tax or tribute.

In the ancient German codes of law, fines and penalties are actually defined in terms of livestock. In the Zend Avesta . . . the scale of rewards to be paid to physicians is carefully stated, and in every case the fee consists in some sort of cattle. . . . Being counted *by the head,* the kine was called *capitale,* whence the economical term *capital,* the law term *chattel,* and our common name *cattle.*

In countries where slaves form one of the most common and valuable possessions, it is quite natural that they should serve as the medium of exchange like cattle. . . .

ARTICLES OF ORNAMENT AS CURRENCY

A passion for personal adornment is one of the most primitive and powerful instincts of the human race, and as articles used for such purposes would be durable, universally esteemed, and easily transferable, it is natural that they should be circulated as money. The wampumpeag of the North American Indians is a case in point, as it certainly served as jewelry. It consisted of beads made of the ends of black and white shells, rubbed down and polished, and then strung

into belts or necklaces, which were valued according to their length, and also according to their colour and lustre, a foot of black peag being worth two feet of white peag. It was so well established as currency among the natives that the Court of Massachusetts ordered in 1649 that it should be received in the payment of debts among settlers to the amount of forty shillings. It is curious to learn, too, that just as European misers hoard up gold and silver coins, the richer Indian chiefs secrete piles of wampum beads, having no better means of investing their superfluous wealth.

Exactly analogous to this North American currency is that of the cowry shells, which, under one name or another—chamgos, zimbis, bouges, procelanes, etc.—have long been used in the East Indies as small money. In British India, Siam, the West Coast of Africa, and elsewhere on the tropical coasts, they are still used as small change, being collected on the shores of the Maldive and Laccadine Islands, and exported for the purpose. Their value varies somewhat, according to the abundance of the yield, but in India the current rate used to be about 5000 shells for one rupee, at which rate each shell is worth about the two-hundredth part of a penny. Among . . . the Fijians, whale's teeth served in the place of cowries, and white teeth were exchanged for red teeth somewhat in the ratio of shillings to sovereigns.

Among other articles of ornament or of special value used as currency may be mentioned yellow amber, engraved stones, such as the Egyptian scarabaei, and tusks of ivory.

CURRENCY IN THE AGRICULTURAL STATE

Many vegetable productions are at least as well suited for circulation as some of the articles which have been mentioned. It is not surprising to find, then, that among a people supporting themselves by agriculture, the more durable products were thus used. Corn (meaning grain) has been the medium of exchange in remote parts of Europe from the time of the ancient Greeks to the present day. In Norway corn is even deposited in banks, and lent and borrowed. What wheat, barley, and oats are to Europe, such is maize in parts of Central America, especially Mexico, where it formerly circulated. In many of the countries surrounding the Mediterranean, olive oil is one of the commonest articles of produce and consumption; being, moreover, pretty uniform in quality, durable, and easily divisible, it has long served as currency in the Ionian Islands, Mytilene, some towns of Asia Minor, and elsewhere in the Levant.

Just as cowries circulate in the East Indies, so cacao nuts, in

Central America and Yucatan, form a perfectly recognised and probably an ancient fractional money. Travellers have published many distinct statements as to their value, but it is impossible to reconcile these statements without supposing great changes of value either in the nuts or in the coins with which they are compared. In 1521, at Caracas, about thirty cacao nuts were worth one penny English, whereas recently ten beans would go to a penny, according to Squier's statements. In the European countries, where almonds are commonly grown, they have circulated to some extent like the cacao nuts, but are variable in value, according to the success of the harvest.

It is not only, however, as a minor currency that vegetable products have been used in modern times. In the American settlements and the West India Islands, in former days, specie used to become inconveniently scarce, and the legislators fell back upon the device of obliging creditors to receive payment in produce at stated rates. In 1618, the Governor of the Plantations of Virginia ordered that tobacco should be received at the rate of three shillings for the pound weight, under the penalty of three years' hard labour. We are told that, when the Virginia Company imported young women as wives for the settlers, the price per head was one hundred pounds of tobacco, subsequently raised to one hundred and fifty. As late as 1732, the legislature of Maryland made tobacco and Indian corn legal tenders; and in 1641 there were similar laws concerning corn in Massachusetts. The governments of some of the West India Islands seem to have made attempts to imitate these peculiar currency laws, and it was provided that the successful plaintiff in a lawsuit should be obliged to accept various kinds of raw produce, such as sugar, rum, molasses, ginger, indigo, or tobacco. Such endeavours were not unlike attempts later on to establish a kind of multiple currency. . . .

The perishable nature of most kinds of animal food prevents them from being much used as money; but eggs are said to have circulated in the Alpine villages of Switzerland, and dried codfish have certainly acted as currency in the colony of Newfoundland.

MANUFACTURED AND MISCELLANEOUS ARTICLES AS CURRENCY

The enumeration of articles which have served as money may already seem long enough for the purposes in view. I will, therefore, only add briefly that a great number of manufactured commodities have been used as a medium of exchange in various times and places. Such are the pieces of cotton cloth, called *Guinea pieces,* used for

traffic upon the banks of the Senegal, or the somewhat similar pieces circulated in Abyssinia, the Soulou Archipelago, Sumatra, Mexico, Peru, Siberia, and among the Veddahs. It is less easy to understand the origin of the curious straw money which circulated until 1694 in the Portuguese possessions in Angola, and which consisted of small mats, called libongos, woven out of rice straw, and worth about 1½d. each. These mats must have had, at least originally, some purpose apart from their use as currency, and were perhaps analogous to the fine woven mats so much valued by the Samoans, and also treated by them as a medium of exchange.

Salt has been circulated not only in Abyssinia, but in Sumatra, Mexico, and elsewhere. Cubes of benzoin gum or beeswax in Sumatra, red feathers in the Islands of the Pacific Ocean, cubes of tea in Tartary, iron shovels or hoes among the Malagasy, are other peculiar forms of currency. The remarks of Adam Smith concerning the use of hand-made nails as money in some Scotch villages will be remembered by many readers, and need not be repeated. M. Chevalier has adduced an exactly corresponding case from one of the French coal-fields.

Were space available it would be interesting to discuss the not improbable suggestion of Boucher de Perthes that, perhaps, after all, the finely worked stone implements now so frequently discovered were among the earliest mediums of exchange. Some of them are certainly made of jade, nephrite, or other hard stones, only found in distant countries, so that an active traffic in such implements must have existed in times of which we have no records whatever.

There are some obscure allusions in classical authors to a wooden money circulating among the Byzantines, and to a wooden talent used at Antioch and Alexandria, but in the absence of fuller information as to their nature, it is impossible to do more than mention them.

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GRESHAM'S LAW

Sir Thomas Gresham in a letter to Queen Elizabeth unwittingly phrased "Gresham's Law." "Ytt may pleasse your majesty to understande thatt the firste occasion of the fall of the exchainge did growe by the Kinges majesty, you latte ffather, in abasinge his quoyne ffrome VI ounces fine to III ounces fine. Wheruppon the exchainge fell ffrome XXVI s. VIII d. to XIIIs IV d. which was the occasion thatt all you ffine goold was convayd ought of this your realme."

But the power of the "bad" money to drive out "good" money was known in the days of Aristophanes (*cir.* 380 B.C.). In his play *Frogs,* he has his chorus recite the following (Frere translation):

Oftentimes have we reflected on a similar abuse
In the choice of men for offices, and of coins for common use;
For your old and standard pieces, valued and approved and tried,
Here among the Grecian nations, and in all the world beside,
Recognized in every realm for trusty stamp and pure assay,
Are rejected and abandoned for the trash of yesterday;
For a vile, adulterate issue, drossy, counterfeit and base,
Which the traffic of the city passes current in their place!

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THE GOLD STANDARD

WALTER E. SPAHR

THE GOLD STANDARD, as the people's automatic brake on their banks and government, places limits on the speed and recklessness with which the government proceeds to spend money. And that is as it should be. There is no reason why a government should be able to spend beyond the nation's reserves and its legitimate borrowing power while every individual in the nation has such limits placed upon him. If an individual should proceed on the basis that he can spend all his savings, then go in debt without limit by passing out his I.O.U.'s and printing all the paper money he needs, we would soon bring his spending orgy to an end.

It ought to be instructive to us in this country to read what a highly reputable European economist has to say about the gold standard as a brake—Wilhelm Röpke in his CRISES AND CYCLES (*William Hodge and Co., Ltd., London, 1936*). He says (*p. 175*): "The automatic safety brake provided by the gold standard has to be considered as an indispensable part of our economic machinery if we want to be safe against real disaster. We do not even trust the locomotive engineer to forego automatic safety appliances in spite of the fact that there are no personal economic interests of his at stake, and that his own personal safety depends on his sense of responsibility. How much less can we do without automatic safety appliances in the case of governments whose affairs are conducted in an atmosphere not entirely free from personal economic interests, and whose leaders are responsible only 'before God and History,' writing their memoirs if anything has gone wrong! It is desirable that all planners, all popular writers on the 'end of capitalism,' and all despisers of 'orthodox' economics should take this to heart, and as far as the policy of trade-cycle con-

trol shares some of the dangers of economic planning, here is a lesson also for the more enthusiastic advocates of monetary management."

But this automatic brake is off our government. The New Dealers removed it in 1933 and thus freed themselves from its restraints. The controls were placed in the driver and the accelerator. And the people have been, and are being, taken for a wild ride. But while the accelerator of speeding is apparently the chief instrument of control used, the dangers are accentuated because many other parts of the machine are not functioning properly—the lubricating oil of capital is but a trickle, there is sand in the bearings!

The gold standard has also been likened to a thermometer which records the soundness (or temperature, as it were) of a nation's money and credit. That is true. If all is not well, the gold standard records the facts; it is a quick and automatic thermometer. And when this thermometer reveals that all is not well, the people and their government respond quickly and the braking process begins. Thus in a very real sense, the gold standard combines the characteristics of both the thermometer and the automatic brake—in other words, it operates much like the modern thermostat.

But the thermometer is buried in Kentucky, and the people have been deprived of both the indicator and the responsive brake. All the while the government managers of our money and credit insist that there is no temperature, that an automatic brake is undesirable, and that all is well.

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THE CROSS OF GOLD

WILLIAM JENNINGS BRYAN

WHEN YOU [turning to the gold delegates] come before us and tell us that we are about to disturb your business interests, we reply that you have disturbed our business interests by your course.

We say to you that you have made the definition of a business man too limited in its application. The man who is employed for wages is as much a business man as his employer; the attorney in a country town is as much a business man as the corporation counsel in a great metropolis; the merchant at the cross-roads store is as much a business man as the merchant of New York; the farmer who goes forth in the morning and toils all day—who begins in the spring and toils all summer—and who by the application of brain and muscle to the natural resources of the country creates wealth, is as much a business man as the man who goes upon the board of trade and bets upon the price of grain; the miners who go down a thousand feet upon the cliffs, and bring forth from their hiding places the precious metals to be poured into the channels of trade, are as much business men as the few financial magnates who, in a back room, corner the money of the world. We come to speak for this broader class of business men.

Ah, my friends, we say not one word against those who live upon the Atlantic coast, but the hardy pioneers who have braved all the dangers of the wilderness, who have made the desert to blossom as the rose—the pioneers away out there [pointing to the West], who rear their children near to Nature's heart, where they can mingle their voices with the voices of the birds—out there where they have erected school houses for the education of their young, churches where they praise their Creator, and cemeteries where rest the ashes of their

dead—these people, we say, are as deserving of the consideration of our party as any people in this country. It is for these that we speak. We do not come as aggressors. Our war is not a war of conquest; we are fighting in the defense of our homes, our families, and posterity. We have petitioned, and our petitions have been scorned; we have entreated, and our entreaties have been disregarded; we have begged, and they have mocked when our calamity came. We beg no longer; we petition no more. We defy them.

* * * *

And now, my friends, let me come to the paramount issue. If they ask us why it is that we say more on the money question than we say upon the tariff question, I reply that, if protection has slain its thousands, the gold standard has slain its tens of thousands. If they ask us why we do not embody in our platform all the things that we believe in, we reply that when we have restored the money of the Constitution all other necessary reforms will be possible; but that until this is done there is no other reform that can be accomplished.

* * * *

We go forth confident that we shall win. Why? Because upon the paramount issue of this campaign there is not a spot of ground upon which the enemy will dare to challenge battle. If they tell us that the gold standard is a good thing, we shall point to their platform and tell them that their platform pledges the party to get rid of the gold standard and substitute bimetalism. If the gold standard is a good thing, why try to get rid of it? I call your attention to the fact that some of the very people who are in this convention to-day and who tell us that we ought to declare in favor of international bimetalism—thereby declaring that the gold standard is wrong and that the principle of bimetalism is better—these very people four months ago were open and avowed advocates of the gold standard, and were then telling us that we could not legislate two metals together, even with the aid of all the world. If the gold standard is a good thing, we ought to declare in favor of its retention and not in favor of abandoning it; and if the gold standard is a bad thing why should we wait until other nations are willing to help us to let go? Here is the line of battle, and we care not upon which issue they force the fight; we are prepared to meet them on either issue or on both. If they tell us that the gold standard is the standard of civilization, we reply to them that this, the most enlightened of all the nations

of the earth, has never declared for a gold standard and that both the great parties this year are declaring against it. If the gold standard is the standard of civilization, why, my friends, should we not have it? If they come to meet us on that issue we can present the history of our nation. More than that; we can tell them that they will search the pages of history in vain to find a single instance where the common people have ever declared themselves in favor of the gold standard. They can find where the holders of fixed investments have declared for a gold standard, but not where the masses have.

Mr. Carlisle said in 1878 that this was struggle between "the idle holders of idle capital" and "the struggling masses, who produce the wealth and pay the taxes of the country"; and, my friends, the question we are to decide is: Upon which side will the Democratic party fight; upon the side of "the idle holders of idle capital" or upon the side of "the struggling masses"? That is the question which the party must answer first, and then it must be answered by each individual hereafter. The sympathies of the Democratic party, as shown by the platform, are on the side of the struggling masses who have ever been the foundation of the Democratic party. There are two ideas of government. There are those who believe that, if you will only legislate to make the well-to-do prosperous, their prosperity will leak through on those below. The Democratic idea, however, is that if you legislate to make the masses prosperous, their prosperity will find its way up through every class which rests upon them.

* * * *

My friends, we declare that this nation is able to legislate for its own people on every question, without waiting for the aid or consent of any other nation on earth; and upon that issue we expect to carry every State in the Union. . . . Our ancestors, when but three millions in number, had the courage to declare their political independence of every other nation; shall we, their descendants, when we have grown to seventy millions, declare that we are less independent than our forefathers? No, my friends, that will never be the verdict of our people. Therefore we care not upon what lines the battle is fought. If they say bimetalism is good, but that we cannot have it until the other nations help us, we reply that, instead of having a gold standard because England has, we will restore bimetalism, and then let England have bimetalism because the United States has it. If they dare to come out in the open field and defend the gold standard as a good thing, we will fight them to the uttermost. Having behind us the producing masses of this nation and the world, supported by the com-

mercial interests, the laboring interests, and the toilers everywhere, we will answer their demand for a gold standard by saying to them: You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold.

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JOINT RESOLUTION OF CONGRESS VOIDING THE GOLD CLAUSE

JOINT RESOLUTION to assure uniform value to the coins and currencies of the United States.

Whereas the holding of or dealing in gold affect the public interest, and are therefore subject to proper regulation and restriction; and

Whereas the existing emergency has disclosed that provisions of obligations which purport to give the obligee a right to require payment in gold or a particular kind of coin or currency of the United States, or in an amount of money of the United States measured thereby, obstruct the power of the Congress to regulate the value of the money of the United States, and are inconsistent with the declared policy of the Congress to maintain at all times the equal power of every dollar, coined or issued by the United States, in the markets and in the payment of debts. Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) every provision contained in or made with respect to any obligation which purports to give the obligee a right to require payment in gold or a particular kind of coin or currency, or in an amount in money of the United States measured thereby, is declared to be against public policy; and no such provision shall be contained in or made with respect to any

obligation hereafter incurred. Every obligation, heretofore or hereafter incurred, whether or not any such provision is contained therein or made with respect thereto, shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts. Any such provision contained in any law authorizing obligations to be issued by or under authority of the United States, is hereby repealed, but the repeal of any such provision shall not invalidate any other provision or authority contained in such law.

(b) As used in this resolution, the term "obligation" means an obligation (including every obligation of and to the United States, excepting currency) payable in money of the United States; and the term "coin or currency" means coin or currency of the United States, including Federal Reserve notes and circulating notes of Federal Reserve banks and national banking associations.

Sec. 2. The last sentence of paragraph (1) of subsection (b) of section 43 of the act entitled "An act to relieve the existing national economic emergency by increasing agricultural purchasing power, to raise revenue for extraordinary expenses incurred by reason of such emergency, to provide emergency relief with respect to agricultural indebtedness, to provide for the orderly liquidation of joint-stock land banks, and for other purposes," approved May 12, 1933, is amended to read as follows:

"All coins and currencies of the United States (including Federal Reserve notes and circulating notes of Federal Reserve banks and national banking associations) heretofore or hereafter coined or issued shall be legal tender for all debts, public and private, public charges, taxes, duties, and dues, except that gold coins, when below the standard weight and limit of tolerance provided by law for the single piece, shall be legal tender only at valuation in proportion to their actual weight."

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PERRY v. UNITED STATES

MR. CHIEF JUSTICE HUGHES delivered the opinion of the court.

* * * *

The Court of Claims has certified the following questions:

1. Is the claimant (J. N. Perry), being the holder and owner of a Fourth Liberty Loan 4¼% bond of the United States, of the principal amount of $10,000, issued in 1918, which was payable on and after April 15, 1934, and which bond contained a clause that the principal is 'payable in United States gold coin of the present standard of value,' entitled to receive from the United States an amount in legal tender currency in excess of the face amount of the bond?

2. Is the United States, as obligor in a Fourth Liberty Loan 4½% gold bond, Series of 1933-1938, as stated in Question One liable to respond in damages in a suit in the court of Claims on such bond as an express contract, by reason of the change in or impossibility of performance in accordance with the tenor thereof, due to the provisions of Public Resolution No. 10, 73rd Congress, abrogating the gold clause in all obligations?

First. The import of the obligation. The bond in suit differs from an obligation of private parties, or of States or municipalities, whose contracts are necessarily made in subjection to the dominant power of the Congress. . . . The bond now before us is an obligation of the United States. The terms of the bond are explicit. They were not only expressed in the bond itself, but they were definitely prescribed by the Congress. . . . The circular of the Treasury Department of September 28, 1918, to which the bond refers "for a statement of the further rights of the holders of bonds of said series," also provided that

the principal and interest "are payable in United States gold coin of the present standard of value."

This obligation must be fairly construed. The *"present* standard of value" stood in contradistinction to a *lower* standard of value. The promise obviously was intended to afford protection against loss. That protection was sought to be secured by setting up a standard or measure of the Government's obligation. We think that the reasonable import of the promise is that it was intended to assure one who lent his money to the Government and took its bond that he would not suffer loss through depreciation in the medium of payment.

The Government states in its brief that the total unmatured interest-bearing obligations of the United States outstanding on May 31, 1933 (which it is understood contained a "gold clause" substantially the same as that of the bond in suit) amounted to about twenty-one billions of dollars. From statements at the bar, it appears that this amount has been reduced to approximately twelve billions at the present time, and that during the intervening period the public debt of the United States has risen some seven billions (making a total of approximately twenty-eight billions five hundred millions) by the issue of some sixteen billions five hundred millions of dollars "of non-gold-clause obligations."

Second. The binding quality of the obligation. The question is necessarily presented whether the Joint Resolution of June 5, 1933 (48 Stat. 113) is a valid enactment so far as it applies to the obligations of the United States. The Resolution declared that provisions requiring "payment in gold or a particular kind of coin or currency" were "against public policy," and provided that "every obligation, heretofore or hereafter incurred, whether or not any such provision is contained therein," shall be discharged "upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts." This enactment was expressly extended to obligations of the United States and provisions for payment in gold, "contained in any law authorizing obligations to be issued by or under authority of the United States," were repealed.

There is no question as to the power of the Congress to regulate the value of money, that is, to establish a monetary system and thus to determine the currency of the country. The question is whether the Congress can use that power so as to invalidate the terms of the obligations which the Government has theretofore issued in the exercise of the power to borrow money on the credit of the United States. In attempted justification of the Joint Resolution in relation to the outstanding bonds of United States, the Government argues that "ear-

lier Congresses could not validly restrict the 73rd Congress from exercising its constitutional powers to regulate the value of money, borrow money, or regulate foreign and interstate commerce"; and, from this premise, the Government seems to deduce the proposition that when, with adequate authority, the Government borrows money and pledges the credit of the United States, it is free to ignore that pledge and alter the terms of its obligations in case a later Congress finds their fulfillment inconvenient. The Government's contention thus raises a question of far greater importance than the particular claim of the plaintiff. On that reasoning, if the terms of the Government's bond as to the standard of payment can be repudiated, it inevitably follows that the obligation as to the amount to be paid may also be repudiated. The contention necessarily imports, that the Congress can disregard the obligations of the Government at its discretion and that, when the Government borrows money, the credit of the United States is an illusory pledge.

We do not so read the Constitution. There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers. In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money *"on the credit of the United States,"* the Congress is authorized to pledge that credit as an assurance of payment as stipulated—as the highest assurance the Government can give, its plighted faith. To say that the Congress may withdraw or ignore that pledge is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such conception of the obligations of our Government.

The binding quality of the obligations of the Government was considered in the Sinking Fund Cases. . . . The question before the Court in those cases was whether certain action was warranted by a reservation to the Congress of the right to amend the charter of a railroad company. While the particular action was sustained under this right of amendment, the Court took occasion to state emphatically the obligatory character of the contracts of the United States. The Court said: "The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that terms implies, as

it would be if the repudiator had been a State or a municipality or a citizen."

When the United States, with constitutional authority, makes contracts, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments. There is no difference, said the Court in United States v. Bank of Metropolis, . . . except that the United States cannot be sued without its consent. . . .

The argument in favor of the Joint Resolution, as applied to government bonds, is in substance that the Government cannot by contract restrict the exercise of a sovereign power. But the right to make binding obligations is a competence attaching to sovereignty. In the United States, sovereignty resides in the people who act through the organs established by the Constitution. . . . The Congress as the instrumentality of sovereignty is endowed with certain powers to be exerted on behalf of the people in the manner and with the effect the Constitution ordains. The Congress cannot invoke the sovereign power of the people to override their will as thus declared. The powers conferred upon the Congress are harmonious. The Constitution gives to Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the Government—upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations. The fact that the United States may not be sued without its consent is a matter of procedure which does not affect the legal and binding character of its contracts. While the Congress is under no duty to provide remedies through the courts, the contractual obligation still exists and, despite infirmities of procedure, remains binding upon the conscience of the sovereign. . . .

The Fourteenth Amendment, in its fourth section, explicitly declares: "The validity of the public debt of the United States, authorized by law . . . shall not be questioned." While this provision was undoubtedly inspired by the desire to put beyond question the obligations of the Government issued during the Civil War, its language indicates a broader connotation. We regard it as confirmatory of a fundamental principle which applies as well to the government bonds in question, and to others duly authorized by the Congress, as to those issued before the Amendment was adopted. Nor can we perceive any reason for not considering the expression "the *validity* of the public debt" as embracing whatever concerns the integrity of the public obligations.

We conclude that the Joint Resolution of June 5, 1933, in so far as it attempted to override the obligation created by the bond in suit, went beyond the congressional power.

Third. The question of damages. In this view of the binding quality of the Government's obligations, we come to the question as to the plaintiff's right to recover damages. That is a distinct question. Because the Government is not at liberty to alter or repudiate its obligations, it does not follow that the claim advanced by the plaintiff should be sustained. The action is for breach of contract. As a remedy for breach, plaintiff can recover no more than the loss he has suffered and of which he may rightfully complain. He is not entitled to be enriched. Plaintiff seeks judgment for $16,931.25, in present legal tender currency, on his bond for $10,000. The question is whether he has shown damage to that extent, or any actual damage, as the Court of Claims has no authority to entertain an action for nominal damages. . . .

Plaintiff computes his claim for $16,931.25 by taking the weight of the gold dollar as fixed by the President's proclamation of January 31, 1934, under the Act of May 12, 1933 (48 Stat. 52, 53), as amended by the Act of January 30, 1934 (48 Stat. 342), that is, at 15 5/21 grains nine-tenths fine, as compared with the weight fixed by the Act of March 14, 1900 (31 Stat. 45), or 25.8 grains nine-tenths fine. But the change in the weight of the gold dollar did not necessarily cause loss to the plaintiff of the amount claimed. The question of actual loss cannot fairly be determined without considering the economic situation at the time the Government offered to pay him the $10,000, the face of his bond, in legal tender currency. The case is not the same as if gold coin has remained in circulation. That was the situation at the time of the decisions under the legal tender acts of 1862 and 1863. . . . Before the change in the weight of the gold dollar in 1934, gold coin had been withdrawn from circulation. The Congress had authorized the prohibition of the exportation of gold coin and the placing of restrictions upon transactions in foreign exchange. Acts of March 9, 1933, 48 Stat. 1; January 30, 1934, 48 Stat. 337. Such dealings could be had only for limited purposes and under license. Executive Orders of April 20, 1933, August 28, 1933, and January 15, 1934; Regulations of the Secretary of the Treasury, January 30 and 31, 1934. That action the Congress was entitled to take by virtue of its authority to deal with gold coin as a medium of exchange. And the restraint thus imposed upon holders of gold coin was incident to the limitations which inhered in their ownership of that coin and gave them no right of action. . . . We cannot say, in view of the conditions that existed, that the Congress having this power exercised it arbitrarily or capri-

ciously. And the holder of an obligation, or bond, of the United States, payable in gold coin of the former standard, so far as the restraint upon the right to export gold coin or to engage in transactions in foreign exchange is concerned, was in no better case than the holder of gold coin itself.

In considering what damages, if any, the plaintiff has sustained by the alleged breach of his bond, it is hence inadmissible to assume that he was entitled to obtain gold coin for recourse to foreign markets or for dealings in foreign exchange or for other purposes contrary to the control over gold coin which the Congress had the power to exert, and had exerted, in its monetary regulation. Plaintiff's damages could not be assessed without regard to the internal economy of the country at the time the alleged breach occurred. The discontinuance of gold payments and the establishment of legal tender currency on a standard unit of value with which "all forms of money" of the United States were to be "maintained at a parity" had a controlling influence upon the domestic economy. It was adjusted to the new basis. A free domestic market for gold was non-existent.

Plaintiff demands the "equivalent" in currency of the gold coin promised. But "equivalent" cannot mean more than the amount of money which the promised gold coin would be worth to the bondholder for the purposes for which it could legally be used. That equivalence or worth could not properly be ascertained save in the light of the domestic and restricted market which the Congress had lawfully established. In the domestic transactions to which the plaintiff was limited, in the absence of special license, determination of the value of the gold coin would necessarily have regard to its use as legal tender and as a medium of exchange under a single monetary system with an established parity of all currency and coins. And in view of the control of export and foreign exchange, and the restricted domestic use, the question of value, in relation to transactions legally available to the plaintiff, would require a consideration of the purchasing power of the dollars which the plaintiff could have received. Plaintiff has not shown, or attempted to show, that in relation to buying power he has sustained any loss whatever. On the contrary, in view of the adjustment of the internal economy to the single measure of value as established by the legislation of the Congress, and the universal availability and use throughout the country of the legal tender currency in meeting all engagements, the payment to the plaintiff of the amount which he demands would appear to constitute not a recoupment of loss in any proper sense but an unjustified enrichment.

Plaintiff seeks to make his case solely upon the theory that by

reason of the change in the weight of the dollar he is entitled to one dollar and sixty-nine cents in the present currency for every dollar promised by the bond, regardless of any actual loss he has suffered with respect to any transaction in which his dollars may be used. We think that position is untenable.

In the view that the facts alleged by the petition fail to show a cause of action for actual damages, the first question submitted by the Court of Claims is answered in negative. It is not necessary to answer the second question.

MR. JUSTICE STONE:

I agree that the answer to the first question is "No," but I think our opinion should be confined to answering that question and that it should essay an answer to no other. . . .

* * * *

MR. JUSTICE McREYNOLDS, MR. JUSTICE VAN DEVANTER, MR. JUSTICE SUTHERLAND, MR. JUSTICE BUTLER, dissenting.

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INFLATION IN GERMANY IN 1923

WILLIAM PHILIP SIMMS

PRINTING-PRESS MONEY to pay government bills left perhaps more ruin and hunger in its wake, in the European nations which tried it, than did the World War.

In Germany, in 1923, I saw workers removing furniture from their homes, piece by piece, to raise the price of enough food to stave off slow starvation.

I saw markets empty and near-empty because farmers at last refused to exchange their produce for paper money which sometimes lost half its value before they could get back home.

The price of a bottle of milk rose as high as 400,000,000,000 marks —worth a hundred billion dollars at par, but at that time only about 10 cents. But as wages had not reached that high level, the average worker's children generally had to go without—even when milk could be found for sale.

Wages rose rapidly. But not nearly so rapidly as the prices which workers had to pay for the things they had to have.

In Berlin I saw a shabbily-dressed woman with a pale, pinched face enter a bank. She carried two baskets. At a teller's window, next to the one where I was standing, she exchanged the two baskets full of million-mark notes for a single greasy dollar bill. "Why?" I inquired. "It's like this," an acquaintance explained. "Today 10 billion marks will buy an American dollar. Next week that same dollar will probably be worth a hundred billion marks. Food, of course, will be in proportion. That poor woman you just saw was exchanging her husband's wages for something stable, so that next week or next month she will still have at least that between her and hunger."

At Dusseldorf, I stepped off a train from Paris. I offered a red cap a hundred billion marks to carry my suitcase to a taxi. He indignantly refused—and small wonder. A little figuring revealed that I had offered him two and a half cents.

A rattle-trap taxi carried me a few blocks to my hotel. The driver charged me a trillion marks. At 25 cents, real money, the ride was a bargain. I gave a bum several billion marks for opening the taxi door, and he did not even thank me.

My dinner, including a half-bottle of Rhinewine and tip, cost me four and a half trillion marks—at par $1,100,000,000,000 (then about $1.10). But my waiter, to whom I gave the 500,000,000,000 mark gratuity (once worth $125,000,000,000), not only never batted an eye but even showed signs of displeasure.

The hotel charged me 10,000,000,000 marks for a sheet of poor writing paper and an envelope. Having left my notebook behind, I used several hundred-million-mark certificates—which, for economy, were printed on one side only—in lieu of a scratch pad.

An acquaintance told me he had to pawn some silver spoons for a railway ticket from Munich to Berlin. I heard it said that marks depreciated so rapidly that tickets for long railway journeys had to be

bought a section at a time, and on the day on which that particular section was to be used.

German inflation did not just happen, all of a sudden. It began during the First World War and the process went on for years—until the fall of 1923. At first the movement went along almost imperceptibly. Then with accelerated speed, it swept on like a typhoon until the country and most of its people were prostrate in its wake.

Instead of boosting taxes to carry on the war, Germany printed a comparatively small amount of fiat money, such as the Patman bonus measure calls for.

To meet post-war expenses, the printing presses were given another whirl.

In May, 1921, a dollar was still worth only 60 marks. By 1923, however, some 30 paper factories, 133 printing offices and 1783 printing machines were going day and night to supply the demand.

Finally, when it became absolutely worthless, and most everybody was ruined, Germany scrapped the whole business and started all over again with a different kind of money.

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INFLATION DURING WORLD WARS I AND II

ROY A. FOULKE

In 1915 there were 28,082 incorporated and unincorporated commercial banks in existence, and by 1920, 30,395. By this time the use of checks drawn on demand bank deposits had become our principal currency. The following table shows the expansion in purchasing media between 1915 and 1920.

	Currency Outside Banks	*Demand Deposits Adjusted*	*Total Purchasing Media*
1915	$1,575,000,000	$ 9,828,000,000	$11,403,000,000
1920	4,105,000,000	19,616,000,000	23,721,000,000

With the growth and exactness in keeping records on banking and money, came refinements in the interpretation of those records. The figures for "Currency Outside Banks" in the above table consists of various types of both bank and government currency; bank money, for example, consisting of National Bank notes and Federal Reserve Bank notes, and government currency of both paper money and coins. Only such amounts of these currencies as are in the hands of the public represent effective purchasing media; currency in the vaults of commercial banks would be included in the total of demand deposits. As a result we now have a more exact figure of the volume of paper currency and coins in daily use.

In a somewhat analogous manner, adjustments have been computed in the demand deposits of commercial banks to ascertain the portion of deposits which are effective as purchasing media. Deposit figures have been adjusted "to exclude inter-bank balances, which do not represent money available to the public, and items in process of collection, inclusion of which would represent a double counting of that part of deposits, that is, at the bank in which the check is deposited and at the bank on which the check is drawn."

In 1915, shortly after World War I exploded in Europe, there was in use currency outside of banks of $1,575 millions and demand deposits adjusted of commercial banks of $9,828 millions, or total purchasing media of $11,403 millions. By 1920 currency outside of banks had increased to $4,105 millions, and demand deposits adjusted of all commercial banks to $19,616 millions, providing total purchasing media of $23,721 millions. Here was over 108 per cent increase in purchasing media within five years.

Demand deposits of commercial banks under normal conditions are increased by granting loans and crediting the proceeds of those loans to the deposits of the borrowers. During the abnormal conditions of a war and a period of deficit government financing, deposits are created in still another way. When funds are needed, and securities of the Federal government cannot be sold in sufficient quantities to insurance companies, savings banks, building and loan associations, organizations, and investing individuals, then they are sold to commercial banks. Commercial banks, in purchasing these securities, either credit the account of the Federal government or draw a check in

payment to the order of the Treasurer of the United States. In the first instance aggregate deposits of the bank are immediately increased. In the second instance, the check of the bank is deposited by the Federal government in some other banking institution, and when that is done, aggregate deposits of the banking system are increased. In other words, the purchase of Federal securities by a bank also increases aggregate deposits. In this way deficit spending, that is, borrowing heavily in excess of tax receipts, finds its way into the volume of purchasing media and a consequent depreciation in currency and increase in the level of wholesale prices.

In 1915 the commercial banks and trust companies of the country had $3,759,983,000 in investments of which $788,703,000 were Federal securities. Five years later commercial banks and trust companies held investments of $8,282,360,000 of which $2,932,102,000 were Federal securities. During this five-year period 45 per cent of the increase in demand deposits adjusted was created by the increased investments of $4,522,377,000.

For 1915 the level of wholesale prices with 1926 as the base of 100 stood at 69.5. For 1917 when we entered the War, the index stood at 117.5 and for 1920 at 154.4. The effect of the greatest increase in purchasing media up to that time in our history did not reach its peak until some time after the end of the War as the result of the widespread speculation in commodities which followed the cessation of hostilities. Between 1915 and 1920 the level of wholesale prices increased 122 per cent. In 1920, prices had reached the same approximate peak as during the War of 1812. Here was our fourth great price inflation.

INFLATION DURING WORLD WAR II

No nation in the history of the world spent money as we did in preparing for and waging World War II. We are still on that spending spree. During the year which ended June 30, 1949, the Federal government spent $36,791 millions and the budget for the fiscal year of 1950 calls for expenditures of $41,858 millions, a figure which will be exceeded by $5 to $6 billions. The potato support program for 1949 alone cost taxpayers $224 millions, Where did we get the money? By borrowing, and a very substantial portion of that borrowing was fashioned by the creation of demand deposits as commercial banks purchased billions of dollars worth of Federal securities. Here is that succinct story between 1940 and 1948:

	Currency Outside Banks	*Demand Deposits Adjusted*	*Total Purchasing Media*
1940	$7,325,000,000	$34,945,000,000	$42,270,000,000
1948	26,079,000,000	85,520,000,000	111,599,000,000

In 1940 the total purchasing media of the country amounted to $42,270 millions consisting approximately of one-sixth currency outside of banks and approximately five-sixths in demand deposits adjusted. Our purchasing media consisted of the same items as after World War I but each item had been blown up tremendously by successive years of heavy government deficits. The total purchasing media of $42,270 millions was almost twice as large as the purchasing media of 1920 when we hit the crest of the inflation following World War I.

Between September 18, and October 18, 1949, twenty-eight countries of the world devalued their currencies. We had done the same thing fifteen years earlier. In 1934, Franklin D. Roosevelt had devalued our currency by reducing the gold content of the dollar from 25⁸⁄₁₀ grains to 15⁵⁄₂₁ grains of gold nine-tenths fine, in other words raising the price of gold from $20.67 to $35.00 a fine ounce. Roosevelt had unsuccessfully attempted to prime the pump; he had originated the novel idea of compensatory spending; and he claimed that the size of the Federal debt made no difference because we "owed it to ourselves."

The devaluation of our currency by raising the price of gold to $35.00 a fine ounce meant that overnight we had a greater dollar amount of gold and hence a larger base for currency, loans and discounts, and investments. Deposits would expand as additional loans and discounts were made by commercial banks or as the additional funds were gradually put into investments. Between 1934 and 1940, loans and discounts expanded nominally as the demand did not exist in that period for loans. As a result the funds gradually went into investments; between 1934 and 1940 investments of commercial banks expanded $6,700 millions.

Between 1940 and 1948 the currency outside of banks increased from $7,325 millions to $26,079 millions, demand deposits adjusted from $34,945 millions to $85,520 millions, and the total purchasing media of the country from $42,270 millions to the unprecedented peak of $111,599 millions. Here was a 164 per cent expansion within eight years.

Between 1940 and 1948 investments of commercial banks and trust companies increased from $25,129 millions to $71,620 millions, an increase of $46,491 millions. Over this same period of years demand

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OBLIGATIONS AND PRIVILEGES OF MEMBER BANKS

By becoming members of the Federal Reserve System, banks become eligible to use all of the System's facilities and, in return, undertake to abide by certain rules that have been developed by law and regulation for the protection of the public interest. National banks are chartered by the Comptroller of the Currency, a Federal Government official, and are subject in their operations to the National Banking Act as well as to the Federal Reserve Act. State-chartered banks that choose to become members of the Federal Reserve System retain their charter privileges but agree to be subject to the general requirements of the Federal Reserve Act. Since these banks join the System voluntarily they have the privilege of withdrawing from membership on six months' notice.

Principal among the obligations assumed by member banks are: (1) To subscribe to the capital of the Federal Reserve Banks an amount equal to 6 per cent of the member's capital and surplus. (Of this, one half must be paid-in and the other half is subject to call. No part of this second half has been called.) (2) To comply with the reserve requirements of the Federal Reserve and to keep the required reserves without interest with the Federal Reserve Banks. . . . And (3) to be subject to various requirements of the Federal Reserve Act with regard to branch banking, holding company regulations, interlocking directorates, and other matters, and, in the case of State Member banks, also to general supervision and examination by the Federal Reserve.

In return, member banks are entitled to the following principal privileges among others: (1) to borrow from the Federal Reserve Banks when in need of additional funds; (2) to use Federal Reserve facili-

ties for collecting checks, settling clearing balances, and transferring funds to other cities; (3) to obtain currency whenever required; (4) to receive a cumulative dividend of 6 per cent on the paid-in captal stock of the Federal Reserve Banks; and (5) to participate in the election of six of the nine directors of each Federal Reserve Bank.

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THE BANKER AND CREDIT INSTRUMENTS

ROLLIN G. THOMAS

THE BANKER'S STOCK IN TRADE consists largely of negotiable credit instruments. The deposits which he receives consist mainly of checks, drafts, and paper currency, all of which are negotiable. Only specie and minor coin are not negotiable in form, yet they, too, have some of the characteristics of bearer-demand negotiable instruments. When the banker receives a deposit, he may create a negotiable instrument directly if he gives the depositor a negotiable certificate of deposit, or indirectly if he enters the amount on the depositor's pass book so as to entitle him to draw checks. The loans and investments of a bank are in the form of negotiable instruments. It is evident, therefore, that the rules governing negotiable instruments are of great importance both to the bank and to those who deal with it.

Types of negotiable instruments. Negotiable instruments fall into two main classes: (1) promises to pay, which include promissory notes and certificates of deposit; and (2) orders to pay or bills of exchange. The latter may in turn be classified as: (a) trade bills or orders drawn on buyers of goods and services by sellers; (b) drafts drawn on banks by customers under an agreement to accept and pay when due; (c) bank drafts or orders drawn by one bank on another,

calling for payment of a certain sum of money to the payee out of the drawer's account; and (d) bank checks. When trade bills are payable at some specific future date, they may be presented to the drawee (the person ordered to pay) for acceptance. An acceptance consists of the signature of the drawee across the face of the bill, with or without accompanying words signifying that he will pay it when due. From that time on, the instrument is known as a *trade acceptance*. Drafts drawn on banks payable at some future date and accepted are known as *bankers' acceptances* or *bankers' bills*.

Test of negotiability. The law requires that a negotiable instrument: (1) be in writing and be signed by the maker or drawer; (2) contain an unconditional promise or order to pay a certain sum of money; (3) be payable on demand or at a fixed or determinable future time; (4) be payable to order or bearer; and (5) when addressed to a drawee, must name him with reasonable certainty.

Importance of negotiability. What difference does it make whether or not a credit instrument is negotiable? The answer is simply this: A person who receives a nonnegotiable instrument by purchase and assignment obtains, like any ordinary assignee, only the rights under the instrument which the previous holder had. If the title of the transferor was faulty in any particular, that of the transferee is equally faulty. For example, if the payee of a nonnegotiable instrument was unable to enforce it because he had been guilty of fraud in procuring the instrument, the person who received the instrument from such payee will also be unable to collect it for the same reason. However, a person who takes a *negotiable* instrument under such circumstances as to be considered a *holder in due course* may obtain better rights to collect it than had the person from whom he received it. This superior position of the holder in due course arises apparently from the fact that the courts are eager to facilitate the use of credit instruments. Their acceptability is considerably enhanced by the protection afforded the holder in due course.

A holder in due course is one who has taken an instrument: (1) that is complete and regular upon its face; (2) before it became overdue and without notice of any previous dishonor; (3) in good faith and for value; and (4) with no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

Defenses against payment. The obligor of a negotiable instrument may refuse to pay and may set up a variety of defenses. These defenses fall into two classes, the first of which comprises those which are good and effective against any and all holders of the instrument, whether or not an innocent holder in due course. These defenses are

absolute, or legal, as they are sometimes called. Under the absolute defenses come: (1) forgery, (2) infancy, (3) insanity, or (4) lack of delivery of an incomplete instrument. The other type of defenses is known as *personal defenses* and is available only against the immediate parties to the instrument or some person other than a holder in due course. The latter is entirely free from defenses of this class. The personal defenses are: (1) fraud, (2) lack of delivery, (3) lack of consideration, (4) wrongful filling out of an incomplete instrument, (5) conditional delivery when the condition has not been fulfilled, (6) illegality, and (7) duress.

Material alteration. A material alteration of a negotiable instrument may consist of changes in: (1) the date, (2) the sum payable, (3) the time or place of payment, (4) the number or the relations of the parties, and (5) the medium or currency in which payment is to be made. It may also consist of the addition of a place of payment where none is specified, or any other change altering the effect of the instrument.

When a negotiable instrument is materially altered without the consent of all parties liable thereon, it is void, except against any person who assented to or participated in the alteration, or against subsequent indorsers. However, a holder in due course who is not a party to the alteration may enforce payment according to the original tenor of the instrument.

Indorsement. A transfer of title to a negotiable instrument involves: (1) delivery alone by one having title, if the instrument is payable to bearer (except that a holder in due course gets title even if the transferor has no title); and (2) indorsement and delivery if the instrument is payable to a certain person or order. There are four common types of indorsement, of which the first is *indorsement in blank*. This consists of mere signature of the indorser, and passes title with delivery. In addition to passing title, the indorser warrants: (1) that the instrument is genuine and in all respects what it purports to be; (2) that he has good title to it; (3) that all prior parties had capacity to contract; and (4) that the instrument at the time of his indorsement is valid and subsisting. Further, he promises that the instrument will be paid if properly presented when due. If the instrument is dishonored and proper notice is given of the fact, the indorser must pay it. After an instrument has been indorsed in blank, it becomes a bearer instrument, negotiable by mere delivery. A second type is the *restrictive indorsement.* This consists of the indorser's signature, accompanied by some expression which prohibits the further negotiation of the instrument. For example, an instrument indorsed "for collection" or

"for deposit" is restrictively indorsed. The person taking an instrument so indorsed is presumed to have been aware of it and holds the instrument as the agent of the indorser; any proceeds realized are held in trust for the indorser. Thus a person taking an instrument bearing a restrictive indorsement cannot become a holder in due course. A third type is the *special indorsement,* specifying the person to whom or to whose order the instrument is to be payable. Its further negotiation requires the indorsement of the indorsee. In case one to whom an instrument is specially indorsed transfers the instrument without indorsing, the transferee is entitled to the indorsement necessary to pass title. A *qualified indorsement* is the fourth variety. This results when the indorser adds to his signature such words as "without recourse," indicating his unwillingness to be bound for payment in case the instrument is dishonored. However, such an indorser assumes full liability for the warranties made by an indorser in blank.

Liability of the parties. The duty of the person of primary liability to pay a negotiable instrument may be qualified by the personal defenses if the instrument is not in the hands of a holder in due course, and in any event by legal defenses. Of the legal defenses, perhaps one of the most common is a forgery in the line of title. The holder in due course cannot recover if he is claiming either through a forgery of the maker's name (if a promissory note) or, in the case of any order instrument, a forgery of the name of the payee or anyone else to whom the instrument is specially indorsed. Moreover, if he receives payment and the forgery is subsequently discovered, the holder must refund the money received. But if a holder in due course presents a bill of exchange to the drawee for acceptance, and the drawee accepts, the holder in due course may enforce payment from the acceptor even though it later appears that the drawer's name was forged. Further, if a holder in due course of a check presents it to the drawee bank for payment, and receives payment, the bank has no recourse against the holder if it later discovers that the drawer's name is forged. This arises from the fact that when the drawee of a bill of exchange accepts (or pays) the same, he promises to pay (or actually pays), and admits the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument.

In order to bind an indorser of a check on his promise to pay the instrument if dishonored, the check must be properly presented and notice of dishonor sent to the indorser. A check is deemed to have been presented in sufficient time to bind the indorsers if it is presented within a reasonable time after its last negotiation. Thus, a holder in due course may protect himself by starting presentment,

either by turning the instrument over to his bank or by other means, within the next business day after receiving it. In case of dishonor, notice must be sent to each indorser against whom the indorser desires recourse. Notice of dishonor may be either in writing or oral, and given in any terms sufficient to identify the instrument and indicate its dishonor. When the holder gives notice of dishonor to one party, all other parties subsequent to the one noticed may benefit from the notice. Notice of dishonor must be started so as to reach the party notified within the next business day if the parties live in the same place. Where the parties to the notice reside in different places, notice of dishonor must be deposited in the post office in time to go by mail the next business day, or, if there is no mail at a convenient hour on that day, by the next mail thereafter. If notice is not sent by mail, it must arrive within the time at which notice properly sent by mail would have arrived. Wherever notice is properly addressed and deposited in the post office (or box), the sender has given sufficient notice, even if the notice never actually arrives. A party receiving notice of dishonor has, after its receipt, the same length of time as the original holder for notifying and binding antecedent parties. Notice of dishonor may be waived.

A dishonored bill of exchange drawn or payable in another state (that is, a foreign bill) must be "protested"; otherwise the drawer and indorser will be discharged. The protest must be annexed to the bill or contain a copy thereof and be under the hand and seal of a notary. It must contain the time, place, and fact of presentment and be sent as notice of dishonor to parties to be held. Any person liable on a bill to subsequent indorsees may waive protest, and this act also waives presentment and notice of dishonor.

Delay in the presentment of checks (unlike other forms of bills of exchange) discharges the drawer only to the extent of the loss which he suffers as a result of such delay. If the drawer has suffered a loss due to the failure of the bank on which the check was drawn, he can be held for payment only if presentment was made within a reasonable length of time *after the check's issue.* Most courts hold that, to be within a reasonable length of time, presentment must be started within the next business day after the check has been received by the payee.

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THE CONSUMERS' PRICE INDEX

THE CONSUMERS' PRICE INDEX for moderate-income families in large cities (formerly known as the "Cost of Living Index") measures average changes in retail prices of goods, rents and services purchased by wage earners and lower-salaried workers in large cities. Until January 1950, time-to-time changes in retail prices were weighted by 1934–36 average expenditures of urban families. Weights used beginning January 1950 have been adjusted to current spending patterns. . . . Individual city data are combined for the United States with the use of population weights.

The indexes do not indicate whether it costs more to live in one city than in another.

Food prices are collected monthly from chain and independent stores in 56 cities during the first 3 days of the week which includes the 15th of the month.

Fuel prices are collected monthly by mail from fuel dealers in 34 cities.

Prices of *apparel, housefurnishings, and miscellaneous goods and services* are obtained from representative retail stores and service establishments in 10 key cities each month and in 24 other large cities quarterly by representatives of the Bureau. Price collection extends over 3 or 4 weeks centered around the 15th of the month. Prices are collected in 8 of the 24 quarterly cities each month in addition to the 10 key cities. The miscellaneous group includes medical care, drugs, household operation, recreation, tobacco products, personal care, transportation, etc.

Rents are obtained from tenants in each of the 34 large cities, three times a year by mail and once a year by personal visit. The rent index measures changes in rent from one period to another for the same

rented dwellings, with the same facilities, furnishings, and services. It is designed to measure only changes in rents—not changes in the amount of money families spend for housing as a result, for example, of moving from town to city, or to better or poorer quarters, or of shifting from renting to owning, whether voluntary or forced because of shortages of homes for rent. The rent index does not reflect such price changes as costs of repairs made by tenants, "extras," or premiums charged by some landlords when they rent to new tenants.

The samples of dwellings from which rents are currently collected were recently brought up to date on the basis of comprehensive housing surveys conducted in each of the 34 city areas between December 1949 and February 1950. These up-to-date samples are representative of tenants living in new as well as old houses and apartments in all sections of each city and its surrounding suburbs. Since 1940, the tenant samples have been revised three times (in 1942, 1944–46 and 1949–50) to keep them representative of rental housing, but the rent component in the old series did not reflect the differences between the rents at which newly-constructed or converted dwellings enter the rental market, and the rents for comparable existing housing.

Until 1950 no accurate measure of the resulting "new unit bias" was possible; but on the basis of the comprehensive housing surveys conducted in early 1950, the Bureau has calculated the cumulative effect of this understatement from 1940 to 1950. On the basis of these calculations the rent and "all-items" indexes have been corrected back to 1940 as part of the adjusted series.

> [The 34 cities mentioned above are Atlanta, Baltimore, Birmingham, Boston, Buffalo, Chicago, Cincinnati, Cleveland, Denver, Detroit, Houston, Indianapolis, Jacksonville, Kansas City (Missouri), Los Angeles, Manchester, Memphis, Milwaukee, Minneapolis, Mobile, New Orleans, New York, Norfolk, Philadelphia, Pittsburgh, Portland (Maine), Portland (Oregon), Richmond, St. Louis, San Francisco, Savannah, Scranton, Seattle, Washington, D. C.]

> [The items entering into the analysis, in terms of groups, are: "All Foods," "Apparel," "Rent," "Fuel, Electricity and Refrigeration," "Housefurnishings," and "Miscellaneous." The "All Foods" item is subdivided into such groupings as: Cereals and bakery products; Meats, poultry, and fish; Dairy products; Eggs; Fruits and vegetables—fresh, canned, dried, frozen; Beverages; Fats and oils; Sugar and sweets.]

The adjustments introduced as of January 1950 include the following:

1. *Revision of Population Weights.* Revised population weights for use in combining data for individual cities into a U. S. average were calculated, using the population figures from the 1950 Decennial Census.
2. *Correction of "New Unit Bias" in Rent Index.* With the release of the October 1950 index, the Bureau published its correction of an understatement of the rent index, caused by the failure of the index to reflect the effect of higher rent charged for new dwellings when they were first rented. This correction, originally published separately from the index, has now been incorporated into the adjusted indexes from January 1950 to date.
3. *Addition of New Items.* Some items not included in the list of items priced for the index up to the present time have been added because they have become important in family spending since the index "market basket" of goods and services was determined in the mid-thirties. For example: frozen foods, canned baby foods, gas for home heating, group hospitalization, home permanents, and television, have been added.

   Other items have been added because they are necessary for accurate measurement of price movement. For example, among the items added to the index list are: electric toasters, cola drinks, and ice cream.
4. *Revision of Commodity Weights.* The importances attached to the various items and groups of items in the index calculations have been adjusted to reflect present-day family spending habits. These adjustments of "weights" are based on recent studies of what families buy and how much they spend. The Bureau has relied principally on its own studies of family expenditures in seven cities since 1947, and its studies of rent and housing costs in 34 cities in late 1949 and early 1950. Valuable information has been drawn also from recent food consumption surveys by the Department of Agriculture, and from trade and official sources on production, marketing, sales and other facts pertinent to consumption and expenditures. Data from all these sources were used to estimate 1949 quantity consumption at 1950 prices, as a basis for adjusted index weights.

PART FOUR

Value and Price

In this Part, Eugen von Böhm-Bawerk's discussion of the nature of subjective value (64) and his well-known illustration of the five sacks of corn (65) are presented. Number 66 is A. R Burns' account of the influence of the competitive system. Numbers 67 and 68 are quotations from Edward H. Chamberlin and deal with competition and monopoly and selling versus production costs. Number 69, by Edwin G. Nourse, deals with pricing. Number 70 is a full-length study of pricing and price policies by R. H. Alt and W. C. Bradford. The point of view of the Council of Economic Advisers is described in Article 71. Number 72, by Paul D. Converse and Harvey W. Huegy, explains the nature of marketing.

Other selections which might be read in connection with this Part are 113 and 120.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged below.

(64) von Böhm-Bawerk, Eugen, *The Positive Theory of Capital,* tr. by William Smart, Stechert, 1923, pp. 133–135.

(65) ———, pp. 149–152.

(66) Burns, A. R., *The Decline of Competition,* McGraw-Hill, 1936, pp. 1–3, 8–11, 15–16.

(67) Chamberlin, E. H., *The Theory of Monopolistic Competition,* Harvard University Press, 1948, pp. 3, 4–7, 11.

(68) ———, pp. 123–125.

(69) Nourse, E. G., *Price-Making in a Democracy,* The Brookings Institution, 1944, pp. 9–17.
(70) Alt, R. M. and W. C. Bradford, *Pricing and Price Policies,* Richard D. Irwin, 1950, pp. 231–254.
(71) Council of Economic Advisers, *The Economic Situation at Midyear, 1951,* Government Printing Office, pp. 151–154.
(72) Converse, P. D. and H. W. Huegy, *Elements of Marketing,* Prentice-Hall, 1944, pp. 1–3.

64 ·

THE NATURE OF SUBJECTIVE VALUE

EUGEN VON BÖHM-BAWERK

All goods without exception—indeed according to the very conception of them as "good"—possess a certain relation to human well-being. There are, however, two essentially distinct grades of this relation. A good belongs to the lower grade when it possesses the general *capacity* to subserve human weal. The higher grade, on the other hand, demands that a good should be more than merely a sufficient cause; it must be an indispensable *condition* of human well-being—a condition of such a kind that some gratification stands or falls with the having or wanting of the good. In the expressive vocabulary of everyday life we find a separate designation for these grades. The lower is called Usefulness, the higher Value. This distinction, already recognized in common speech, we must try to make as clear and well-marked as its fundamental importance for the whole theory of value deserves.

A man dwells beside a bubbling spring of water. He has filled his cup, and the spring goes on pouring out enough to fill a hundred other cups every minute. Another man is travelling in the desert. A long day's journey over glowing sand still divides him from the nearest oasis, and he has come to his last cup of water. What is the relation in each case between the cup of water and the well-being of its owner?

A single glance shows us that the relation is very dissimilar; but wherein lies the difference? Simply that, in the former case, we have only the lower grade of the relation we call well-being, that of usefulness; in the latter case we have the higher grade as well. In the first case, just as in the second, the cup of water is useful, that is, capable of satisfying a want, and, moreover, in exactly the same degree;

for evidently the refreshing qualities of the water—the qualities on which its capacity to quench thirst is based, such as coolness, taste, etc.—are not in the least weakened by the fact that other cups of water chance to possess similar properties; nor, in the second case, are these refreshing qualities in the least augmented by the accidental circumstance that there is no other water near. On the other hand, the two cases become essentially distinct when considered with reference to the second grade. Looking at the former case we must say that the possession of water does not provide the man with one single satisfaction more, nor its loss with one satisfaction less, than he could have obtained without it. If he has that particular cup of water he can quench his thirst with it; if he has not that cup—well, he can quench his thirst quite as well with one of the hundred others which the spring puts freely at his disposal every minute of the day. If he likes, therefore, he may make that one cup the *cause* of his satisfaction by quenching his thirst with it; an *indispensable condition* of his satisfaction it cannot be; for his well-being it is dispensable, unimportant, indifferent.

It is quite otherwise in the second case. Here we must say that, if our traveller had not that one last cup, he could not quench his thirst; he must bear its pangs unassuaged, perhaps even succumb to them. In the cup of water then, in this case, we see not merely a sufficient cause, but the indispensable condition, the *sine qua non* of human well-being. Here it is of consequence, even of urgency; it possesses importance for his well-being.

Now it is not too much to say that the distinction here drawn is one of the most fruitful and fundamental in the whole range of our science. . . . It has its life in the world of men, who know it and use it and take it as guide for their common attitude towards the world of goods, not only as regards the intellectual estimate they apply to these goods, but as regards their actual business transactions. About goods which are only useful the practical business man is careless and indifferent. The academic knowledge that a good may be "of use" cannot evoke any efficient interest in the good, in the face of the other knowledge that the same use may be obtained without it. Such goods are practically naught as regards our well-being, and we treat them as such; we are not put about when we lose them, and we make no effort to gain them. Who would fret at, or make an effort to prevent, the spilling of a cup of water at the spring, or the escape of a cubic foot of atmospheric air? Where, on the other hand, the sharpened glance of the economic man recognizes that some satisfaction, well-being, gratification, is connected with a particular good, there the

effective interest which we take in our well-being is transferred to the good which we recognize as its condition; we see and value our own welfare in it; we recognize its importance for us as value; and finally, we develop an anxiety, proportioned to the greatness of that importance, to acquire and hold the good.

Thus, formally defined, value is the importance which a good or complex of goods possesses with respect to the well-being of a subject. . . .

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FIVE SACKS OF CORN

EUGEN VON BÖHM-BAWERK

A COLONIAL FARMER, whose log hut stands by itself in the primeval forest, far away from the busy haunts of men, has just harvested five sacks of corn. These must serve him till the next autumn. Being a thrifty soul he lays his plans for the employment of these sacks over the year. One sack he absolutely requires for the sustenance of his life till the next harvest. A second he requires to supplement this bare living to the extent of keeping himself hale and vigorous. More corn than this, in the shape of bread and farinaceous food generally, he has no desire for. On the other hand, it would be very desirable to have some animal food, and he sets aside, therefore, a third sack to feed poultry. A fourth sack he destines for the making of coarse spirits. Suppose, now that his various personal wants have been fully provided for by this apportionment of the four sacks, and that he cannot think of anything better to do with the fifth sack than feed a number of parrots, whose antics amuse him. Naturally these various methods of employing the corn are not equal in importance. If, to express this shortly in figures, we make out a scale of ten degrees of

importance, our farmer will, naturally, give the highest figure 10 to the sustenance of his life; to the maintenance of his health he will give, say, the figure 8; then going down the scale, he might give the figure 6 to the improvement of his fare by the addition of meat, the figure 4 to the enjoyment he gets from the liquor, and, finally, to the keeping of parrots, as expressing the least degree of importance, he will give the lowest possible figure 1. And now, putting ourselves in imagination at the standpoint of the farmer, we ask, What in these circumstances will be the importance, as regards his well-being, of *one* sack of corn?

This, as we know, will be most simply tested by inquiring, How much utility will he lose if a sack of corn gets lost? Suppose we carry out this in detail. Evidently our farmer would not be very wise if he thought of deducting the lost sack from his own consumption, and imperilled his health and life while using the corn as before to make brandy and feed parrots. On consideration we must see that only one course is conceivable: with the four sacks that remain our farmer will provide for the four most urgent groups of wants, and give up only the satisfaction of the last and least important, the marginal utility—in this case, the keeping of parrots. The only differences, then, that his having or not having the fifth sack of corn makes to his well-being is that, in the one case, he may allow himself the pleasure of keeping parrots, in the other he may not; and he will rightly value a *single* sack of his stock according to this unimportant utility. And not only one sack, but *every* single sack; for, if the sacks are equal to one another, it will be all the same to our farmer whether he lose sack A or sack B, so long as, behind the one lost, there are still four other sacks for the satisfying of his more urgent wants.

To vary the illustration, assume that our farmer's wants remain the same, and that he has only three sacks of grain. What now is the value of one sack to him? The test again is quite easily applied. If he has three sacks he can and will provide for the three most important groups of wants. If he has only two sacks, he will be obliged to limit himself to the satisfying of the two most important groups and give up satisfying of the third, that of animal food. The possession of the third sack—and the third sack, be it remembered, is not a definite sack but any of the three sacks, so long as there are other two behind it—directly carries with it, therefore, the satisfaction of his third most important want; that is, the last or least of those wants covered by the three sacks which constitute his total stock. Any estimate other than that according to the marginal utility would, in this case also, obviously run counter to facts, and would be quite incorrect.

Finally, suppose that our farmer's wants remain as before, and that he only possesses one single sack of corn. In this case it is perfectly clear that all less important methods of employing the corn are out of court, and that it will be devoted to and spent in sustaining the farmer's life—a function for which it just suffices. His possession of the sack, therefore, means life; his loss of it means death; the single sack of corn has the greatest conceivable importance for the well-being of the farmer. And all this is still in conformity with our principle of marginal utility. The greatest utility—the preservation of life—is here the sole, as well as the last or marginal utility.

These estimates according to marginal utility are not merely "academic." No one will doubt that our farmer on due occasion—say, on an offer made him for the corn—would act practically according to the same estimates. Any one of us, placed in his position, would undoubtedly be inclined to let one of the five sacks go pretty cheap in consideration of and in correspondence with its small marginal utility. He would charge considerably more for one of the three sacks. And he would not let the irreplaceable *single* sack, with its enormous marginal utility, go for any price whatever.

66 ·

THE COMPETITIVE SYSTEM

ARTHUR ROBERT BURNS

COMPETITIVE CAPITALISM was given a protracted and thorough trial in the United States after the Civil War. Although legal institutions were framed with a broad and consistent regard for the assumptions of competition, capitalism failed to preserve its competitive quality. The National Industrial Recovery Act of 1933 was a belated recognition of this failure.

In spite of notable caveats, economic writings analyzing the implications of competition were read as beguiling briefs for laissez faire. Competition assured to buyers a supply of goods at prices just high enough to cover costs; it induced an allocation of resources between different uses that ensured the most efficient satisfaction of demands; the competitive struggle eliminated the least fit from each industry. It is true that the endorsement of competition meant the acceptance of the existing distribution of incomes, but this difficulty was easily swallowed; people must be allowed to enjoy the fruits of their competitive efforts to satisfy the consumer (with purchasing power). In its more dynamic aspects the competitive society was under the greatest possible urge to improve the methods of turning resources to the satisfaction of demand (backed by purchasing power).

Adam Smith's "obvious and simple system of natural liberty" has, however, never been fully accepted; slavery and the tariff constituted early and important exceptions. But exceptions soon began to increase in number; no amount of arguing that certain industries are "affected with a public interest" can conceal a growing doubt concerning the capacity of competition to survive or, where it survives, to produce satisfactory results. Even in the larger fields regarded by the Supreme Court as not "affected with a public interest" the fruits of competition failed to ripen. At least as early as the eighties competition gave place to pools and agreement in the meat, steel, salt, whisky, coal, cordage, explosives, and a number of other industries. Single corporations secured control of a very large part of all the business in the sugar, starch, oil, tobacco, and many branches of the steel fabricating industries. Some of these corporations attained their position by methods both dramatic and ruthless. These phenomena were regarded, however, as manifestations of the pathological tendencies in a few individuals. The possibility that they arose out of contradictions deep in the very nature of competitive individualism was ignored. It was said that "there ought to be a law about it" and there was.

For forty years the Supreme Court, armed with the phrases "restraint of trade" and "monopoly," sought to compel normal (in the sense of competitive) behavior. It sank into a bog of doubt concerning "intent," taking its frail gauges of normality with it. There bubbled up a few dicta that "mere size is no offense," that "the fact that competitors may see fit in the exercise of their own judgment to follow the prices of another manufacturer does not establish any suppression of competition or show any sinister domination," and that the stability of a price for some ten years must be ignored because "there is a danger of deception in generalities." The court was doubtless wise not to look

where it was going; any attempt to guide industrial evolution would have raised a multitude of problems with which it was both unwilling and unqualified to deal. The economists turned away to a tedious and fruitless analysis of the court's verbal rationalizations of its decisions. Meanwhile fear of price cutting has become increasingly pervasive. With increasing frequency price cutting is referred to as "cutthroat." Sellers have sought to establish relationships immune from attack under the law and yet capable of facilitating the making of prices without resort to short-term price cutting.

Only recently has it been realized that judgment of industries by reference to the categories of competition and monopoly is impossible. Monopolies in the crude sense of single sellers of products for which there are no nearby substitutes are extremely rare. On the other hand industries in which there is more, and sometimes many more, than one seller fail to display all the qualities of competition. Attempts to resolve the problem by unearthing agreements concerning output and prices quickly disintegrate into detective work and innuendo; if business men have one tenth of the foresight attributed to them by economists they see to it that there is no written evidence of collusion. But, apart from collusion, business men seeking to maximize profits in the most rational and far-sighted manner no longer invariably choose lines of conduct calculated to yield the fruits of competition. Elements of monopoly have always been interwoven with competition but the monopoly elements have increased in importance. They can no longer be regarded as occasional and relatively unimportant aberrations from competition. They are such an organic part of the industrial system that it is useless to hope that they can be removed by law and the industrial system thus brought into conformity with the ideal of perfect competition.

* * * *

TECHNOLOGICAL CAUSES OF THE DECLINE IN THE NUMBER OF SELLERS

This difference in attitude between the perfectly and the imperfectly competitive business turns upon its size in relation to its market. It is a commonplace that the number of firms in many industries has been falling. In many markets, e.g., those for steel, automobiles, rubber tires, sugar, corn products, electrical products, air transportation, agricultural implements, the number is already too small for sellers to ignore the effect of changes in their output upon the price of the commodity and, therefore, upon their revenue. The reduction

of the number of firms and their increasing size over the past half century are clearly due, in part, to the use of methods of production which are economical only if large quantities are produced under a single organization. These economies arise from plant reorganization, or from the reorganization of management or selling methods. The increased volume of business necessary to permit the utilization of these methods of production has been attained in part by price cutting; the largest firms, however, have more frequently attained their present size either by direct attacks upon rivals in the form of temporary or local price cutting aimed at destroying them, by defaming their products and the like, or by mergers. Whether or not such practices are approved, they may serve to adjust the productive system to the utilization of more economical methods of production, and they may be preferred to price competition because buyers are slow to respond to price cutting. Such methods of growth may, however, also be resorted to as a means of attaining a size larger than the most economical with the object of securing control of prices; they may merely satisfy the desire for size on the part of the managers. At least it is clear that, under a system once broadly competitive, methods of producing many commodities have changed in favor of the large firm; the very competition that induces the most economical utilization of the means of production has induced the survival of firms so large and so few that perfect competition itself no longer survives in a number of industries.

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SOCIAL POLICY AND THE DECLINE IN THE NUMBER OF SELLERS

CORPORATION LAWS

Although social policy is assumed to have been aimed in general at the maintenance of competition, it has in many ways reinforced the movement away from competition. The policies of states in the exercise of their powers to control the forms of corporate organization have fundamentally changed the environment in which price and production policies are made. The widespread adoption of the corporate form for organizing production has eliminated individual ownership from considerable portions of the industrial and commercial field. Decisions concerning the utilization of the means of production no longer rest with those who "own" them and, therefore, receive the

whole profits resulting from skillful and fortunate decisions, and suffer the whole losses resulting from unskillful or unfortunate decisions. The forces playing upon those who make policy within each group are no longer identical with those influencing the individual entrepreneur.

Corporation law has most directly contributed to the passing of competition, however, by providing for the transfer of business to small numbers of larger firms. This facilitation of the organization of large units has not only permitted the utilization of improved methods of production calling for units of large size; it has also facilitated the formation of units larger than those necessary to permit the most economical methods of production. Political power having been in part illusory and in part distasteful, economic power has been sought. Its attainment may lead to attempts to overcome the inefficiencies of excessive size. Energy, initiative, and equipment are directed to making these aggregations of economic resources as efficient as smaller ones; if these efforts are successful, the tendency to smaller numbers of sellers is reinforced. Corporate units tend to increase in size partly because of internal tendencies to expansion and partly because of external tendencies to grow by accretion. The separation within the group of the functions of management from those of ownership, and the concentration of the former in a few hands, have resulted in fact in a large share of profits being retained in the business; the "owners" have little opportunity to dispose of these profits as they would if the profit were all distributed in dividends; 29.4 per cent of their net income was retained within the larger corporations during the period 1922 to 1927. This retention may be intended to avoid shortages of liquid resources in periods of restricted business or to permit the continued payment of dividends in the absence of adequate current profits. But it also facilitates expansion without the necessity of issuing new securities; those managers who find size attractive can satisfy their desire without having to submit their plans to the test of the capital market. Mergers offer similar opportunities for satisfying the desire for size. They usually involve either the flotation of new securities or the exchange of securities with the owners of the corporation to be absorbed; investors in times of good business take such a very optimistic attitude toward the profitability of mergers that growth by accretion in this way is facilitated. Finally, the joining of corporation with corporation offers such large profits to those who arrange the matter that the corporation laws have provided a positive inducement to increase the size and reduce the number of firms in many industries.

PATENT LAWS

The law with regard to patents rests upon a departure from competition. The prospect of monopoly profits protected by law for a prescribed period is held out as a bait to encourage the improvement of methods of production. The contribution of the patent law to the decline of price competition has passed far beyond the limits suggested by this principle. The owners of some patents have, by the exclusive exploitation of their rights, secured legal protection for the establishment of manufacturing units so large that they were impregnable by the time the patent expired. . . .

The patent law itself may prolong the protection of the monopolist. Patents upon improvements cannot be exploited without license from the holder of the basic patent; those who patent improvements can often market their patents only by selling them to the holder of the basic patent, who can secure them at a relatively low price. The holder of the basic patent has a great advantage over any rivals who may arise after the basic patent has expired because no rival can offer a product carrying all the most recent improvements.

* * * *

Competitive conditions are also affected by the rights of patentees to "put their patents to sleep." Policy in this matter has also changed during the past 35 years. Until about 1898 patents were required to be utilized if the right was to be preserved. In 1896, however, it was held for the first time that the suppression of a patent was within the rights of the patentee, and the principle was acknowledged by the Supreme Court in 1908 and again in 1916. Patents have been "put to sleep" by the American Tobacco Company, the United Shoe Machinery Company, the American Steel and Wire Company, the General Electric Company, and the American Bell Telephone Company; patents covering the automatic telephone and paper-bag-making-machinery were suppressed. If the patent upon a new method of production is acquired by a new firm (which calculates that it can reduce prices and still cover total costs of production by the new method), prices are likely to be reduced to that level. As the demand for the output of the existing producers will be diminished as well as the price, a large producer can afford to pay up to the capitalized value of these threatened losses in order to acquire the patent. Unless total costs of production by the new method exceed the marginal costs of production by the old, the utilization of the new method will be postponed and prices maintained. The buyer of the patent is less well off than if he had not been compelled to buy the patent; but he may be better

off than he would have been had the patent fallen into the hands of a producer not already committed to the old methods. If he does utilize the new patent the price of his product will probably be reduced; but the costs of production by new methods are always uncertain and a firm already committed to old methods is apt to be biased in favor of continuing to use the methods with which it is familiar. Thus a law intended to encourage the improvement of methods of production is interpreted so as to permit the obstruction of the utilization of new knowledge in order to protect those who have committed themselves to methods now obsolete. This difficulty arises out of the fact that producers must commit themselves for such long periods of time.

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COMPETITION AND MONOPOLY

EDWARD HASTINGS CHAMBERLIN

Economic literature affords a curious mixture, confusion and separation, of the ideas of competition and monopoly. On the one hand, analysis has revealed the differences between them and has led to the perfection and refinement of a separate body of theory for each. Although the two forces are complexly interwoven, with a variety of design, throughout the price system, the fabric has been undone and refashioned into two, each more simple than the original and bearing to it only a partial resemblance. Furthermore, it has, in the main, been assumed that the price system is like this—that all the phenomena to be explained are either competitive or monopolistic, and therefore that the expedient of two purified and extreme types of theory is adequate.

On the other hand, the facts of intermixture in real life have subtly

worked against that complete theoretical distinction between competition and monopoly which is essential to a clear understanding of either. Because actual competition (rarely free of monopoly elements) is supposedly explained by the theory of pure competition, familiar results really attributable to monopolistic forces are readily associated with a theory which denies them. This association of the theory of competition with facts which it does not fit has not only led to false conclusions about the facts; it has obscured the theory as well. This is the more serious because the mixture of the two forces is a chemical process and not merely a matter of addition. Slight elements of monopoly have a way of playing unexpected logical tricks, with results quite out of proportion to their seeming importance.

* * * *

The second step must be a synthesis of the two. This brings us back to the assertion that price theories have followed, in the main, the two extreme channels, without (conscious) recognition of a middle course. Quantitatively, competitive theory has dominated—indeed, the theory of competition has been so generally accepted as the underlying explanation of the price system that the presumption is in its favor; its inadequacy remains to be proved. Hints at the ubiquity of monopoly elements and at the possibility of an intermediate theory are not entirely lacking, however. Thus Professor Knight remarks that "in view of the fact that practically every business is a partial monopoly, it is remarkable that the theoretical treatment of economics has related so exclusively to complete monopoly and perfect competition," and Veblen, ". . . it is very doubtful if there are any successful business ventures within the range of modern industries from which the monopoly element is wholly absent." Such fragmentary recognition of the problem is not hard to find. Yet, with the exception of the theory of duopoly, the middle ground between competition and monopoly remains virtually unexplored and the possibilities of applying such a theory relatively little appreciated.

"Pure competition" is taken as a point of departure, the adjective "pure" being chosen deliberately to describe competition unalloyed with monopoly elements. It is a much simpler and less inclusive concept than "perfect" competition, for the latter may be interpreted to involve perfection in many other respects than in the absence of monopoly. It may imply, for instance, an absence of friction in the sense of an ideal fluidity or mobility of factors such that adjustments to changing conditions which actually involve time are accomplished instan-

taneously in theory. It may imply perfect knowledge of the future and the consequent absence of uncertainty. It may involve such further "perfection" as the particular theorist finds convenient and useful to his problem. Two illustrations will serve to bring out the contrast between pure and perfect competition. The actual price of wheat approximates very inaccurately its normal price, yet the individual wheat farmer possesses not a jot of monopoly power. The market, though a very imperfect one, is purely competitive. On the other hand, monopoly may exist under conditions which are "perfect," or "ideal," in other respects. The static state and perfect competition are wrongly treated as synonymous by J. B. Clark. There is no reason whatever why monopoly of all sorts and degrees should not be present in a state where the conditions as to population, the supply of capital, technology, organization, and wants remained unchanged. "Pure" and "perfect" competition must not be identified; and to consider the theory of monopolistic competition vaguely as a theory of "imperfect" competition is to confuse the issues.

Monopoly ordinarily means control over the supply, and therefore over the price. A sole prerequisite to pure competition is indicated—that no one have any degree of such control. This, however, may be analyzed into two phases. In the first place, there must be a large number of buyers and sellers so that the influence of any one or of several in combination is negligible. There is no need that their numbers be infinite (although to treat them for certain purposes as though they were is perfectly legitimate and necessary), but they must be large enough so that, even though any single individual has, in fact, a slight influence upon the price, he does not exercise it because it is not worth his while. If the individual seller produces on the assumption that his entire output can be disposed of at the prevailing or market price, and withholds none of it, there is pure competition so far as numbers are concerned, no matter at what price he actually disposes of it, and how much influence he actually exerts.

* * * *

"Pure competition" is descriptive of particular markets, not of the price system generally. This latter is a composite of purely competitive markets, of monopolistic markets (as that term has ordinarily been understood), and of markets where monopolistic and competitive influences are variously commingled. The monopolistic influence being generally towards prices higher than they would be under pure competition, the idea of a purely competitive system is inadmissible; for

not only does it ignore the fact that the monopoly influence is felt in varying degree throughout the system, but it sweeps it aside altogether, describing prices as "tending" towards a level which is generally too low. In fact, as will be shown later, if either element is to be omitted from the picture, the assumption of ubiquitous monopoly has much more in its favor. But neither extreme is defensible without going further, for a true picture of the price system involves recognition of its diversity. From this point of view, the theory of pure competition is of interest because it describes a portion of economic activity.

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SELLING VERSUS PRODUCTION COSTS

EDWARD HASTINGS CHAMBERLIN

Cost of production includes all expenses which must be met in order to provide the commodity or service, transport it to the buyer, and put it into his hands ready to satisfy his wants. Cost of selling includes all outlays made in order to secure a demand, or a market, for the product. The former costs create utilities in order that demands may be satisfied; the latter create and shift the demands themselves. A simple criterion is this: of all the costs incurred in the manufacture and sale of a given product, those which alter the demand curve for it are selling costs, and those which do not are costs of production.

Cost of production is not the same as manufacturer's price, nor is cost of selling the same as the difference between this and the final retail price. Many costs incurred after a commodity leaves the factory are costs of production—those for transportation, handling, storing, and delivering, all of which add utilities to the good, i.e., make it

more capable of satisfying wants. Likewise, there are included in the manufacturer's price to the wholesaler charges to cover the expenses of building up his "connections" and securing outlets, as well as similar charges of other producers who have sold him raw materials and supplies, and whose selling expenses he has recouped. The two types of costs are interlaced throughout the price system, so that at no point, such as at the completion of manufacture, can one be said to end and the other to begin.

The entire cost of a good to the consumer may, however, be analyzed into its two parts by a successive consideration of the outlays of everyone who has had anything to do with producing or selling it, from the retailer or salesman back to its obscure origin. Many costs will at once fall wholly into one category or the other. Selling costs of this type are: advertising in its many forms, salaries of salesmen and the expenses of sales departments and sales agencies (except where these agencies actually handle the goods), window displays, and displays and demonstrations of all kinds. In other cases an outlay covers both, and the total must be divided according to the degree to which it pertains to one function or to the other. A large part of the expenses of those engaged in the "distribution" of products are of this sort, and most profits are a composite income. To the extent that the business man concerns himself with the efficient conduct of his plant, the minimum profits he requires are a cost of production; to the extent that he devotes his time and energies to building up his "connections," they are costs of selling.

One or two types of costs *apparently* increase demand, but are really costs of production. Transportation is an example, since nothing could be sold if the goods were not conveyed to market. This outlay might be thought of as one made to secure a demand, the demand being zero *at the factory*. This view, however, is seen to be false if we suppose the consumer to order the goods directly from the manufacturer and to pay the freight himself, as in the case of a mail order establishment. The demand is not zero at the factory—it exists at a price equal to the price delivered minus the transportation cost. This is always true, whether the buyer pays the transportation charges directly or whether he pays them indirectly in the price of the article. In either case, the demand was always present, both at the market and at the factory. The fact that it might not have been satisfied had the cost not been incurred does not mean that the cost created the demand. This could be said equally well of the material and labor which have gone into the product—and of production costs generally.

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PRICE-MAKING, A KEY TO ECONOMIC ANALYSIS

EDWIN G. NOURSE

Our modern economic world is organized and conducted primarily in terms of money exchanges. The results of our economic management, private and public, express themselves primarily in prices of goods and services and in the money incomes of the various participants in the economic process. If business organization or practice is bad, the ill effects are seen in prices; if prices are unconsciously distorted or purposely manipulated they lead to demoralization of markets and eventual decline of production and consumption. Pointing the way to maximum efficiency in price-making institutions and practices is the goal of economic science in a free economy.

Prices fall conveniently into three classes, according to the processes by which they are arrived at. At one pole is the simple, natural, flexible kind of prices that emerge spontaneously in free markets patronized by individual unorganized producers and buyers. These we shall call "automatic" prices, since no individual or agency assumes any particular responsibility for them. At the opposite pole lies "authoritarian" price-making. Under it, prices do not emerge spontaneously in free markets but are registered by a formal procedure of "price-fixing." Public control undertakes to direct the course of prices as part of a planned economy. This centralizing of power and responsibility holds a strong appeal for some minds, but many turn from it with grave apprehension.

Between these two extreme types of price-making lies the middle ground of "administered prices"—those to be found in situations in which the seller is a sufficiently important factor in the market and

has sufficient control over productive resources to make it possible for him to adopt and carry out a price-and-production policy. This area embraces the major part of modern industrial life with its large corporate producers, chain stores, trade associations, collective bargaining unions, and co-operative organizations. And yet the peculiarities, possibilities, and demands of this kind of price-making have by no means been mastered by businessmen or adequately examined by economists. We can best approach its description and analysis by examining briefly the characteristic features of the systems which flank it on either side.

AUTOMATIC PRICES UNDER SIMPLE COMPETITION

The essence of automatic price-making is to be found in the process of individual bargaining. Economics got its start as a branch of formal learning at a time when the tide of individual freedom of productive effort and bargaining activity was just beginning to rise or to reassert itself. Serfdom and feudal obligations had been largely done away with. Exploration and colonization had increased the mobility of labor and the activity of trade. The medieval guild had passed; the labor union had not yet emerged. Money exchange was highly developed, but financial controls had not grown much beyond individual or family limits. While handicraft had begun to yield to factory methods, establishments were small and largely personal in both ownership and management. From top to bottom of society, the individual was released from old obligations and endowed with new rights and resources. Personal competition had not been absent before this time, but it had been much in the manner of animals struggling over an inadequate "kill." The new competition which emerged in the late eighteenth and early nineteenth centuries took on a more dynamic quality as increases in productive efficiency, derived from new explorations and techniques, became more and more available.

The times begot their relevant philosophy. Adam Smith gave it classic expression. The heart of his doctrine was that if the individual was left free to exert himself in the midst of opportunities and was given responsibility for his own well-being, self-interest would produce results better than could be achieved under any program of official direction. Prices, reflecting the actions of economically free men, could not be quarreled with any more than one could quarrel with the thermometer for registering the temperature. Moreover, this free price system would, like a thermostat, be not merely a recording device

but also one of control. If prices went up sharply, production would be stimulated to reduce the shortage; if down, it would be checked until the glut was relieved.

Under such conditions, it was reasoned, the seller, if his sales returns do not permit him to recoup costs, will shift his effort to some more promising line of endeavor. This will keep labor and capital always moving away from the spot where production is relatively overdone and, since everyone is free to enter any business, toward the places where production is so scarce as to cause a product to command a premium over costs, that is, profit above the normal. Thus the nation would benefit from sound direction and co-ordination of activities as well as from the greater stimulation derived from the freeing of individual enterprise.

In this remote and somewhat idealized situation, prices will be registered automatically as the expression of the balance which spontaneous supplies and demands strike in the market. The "economic man," using only common sense in the pursuit of the individual interest or advantage which he can see just beyond the tip of his nose, may be relied upon to keep supplies constantly adjusting themselves to demands. Laissez faire becomes the almost obvious rule of conduct for government in its relation to economic life. There are no unemployed workers, since everyone accepts the best employment that is offered, no idle funds since capital is saved only under the spur of an adequately rewarding price or interest rate, no persistently unutilized plant capacity since an "economic man" will accept a lower rent in preference to disuse.

While it was the professional economist who elaborated this theory of automatic price-making, the businessman has been quick to admire the picture and accept it for himself. He has indeed been prone to put it forward as an explanation of price movements even today, although conditions are quite different from those to which the original theory was applied. The major point in that difference is that economic life is no longer dominated by the business operations of individual producers and traders. Great blocks of capital, management, and labor having crystallized in modern business, the flow of automatic price-making and its accompanying economic adjustments gives place to consciously previewed and purposely directed group operations. To facilitate these developments or to remedy defects in the economic society thus evolving, government has piled up enabling acts and regulatory acts until the automatic price-making process of laissez-faire theory (and partial application) has largely disappeared. While some

people take alarm at this change and seek the restoration of the automatic system, others place their hopes in the elaboration of fuller and better controls.

THE FACE AND FORM OF AUTHORITARIAN PRICE-FIXING

In our own country, we have had a small but growing amount of price-making by government authority. In the main it has been limited to public regulation of prices charged by private producers, the object being to protect consumers by setting maximum prices or to protect producers by setting minimum prices. Examples include public utility regulation, railroad rate control, the Guffey coal acts, and both federal and state milk controls. More general schemes of price-fixing reappear perennially as proposals for dealing with the agricultural problem, and the ultimate scope and character of price control under the war influence is yet to be seen. Abroad, we see comprehensive systems of authoritarian price-fixing under Communism, Fascism, and the National Socialism of the Third Reich. Many of them go beyond the regulation of prices and rates charged by private business to include prices fixed by government agencies which are themselves producers.

It is indeed a striking feature of experiments which begin with mere price regulation that they rapidly spread to ever-wider controls over the field of business. Once a price or group of prices has been formulated and promulgated, the control agency may find itself called upon to take active steps to support and effectuate it in the market. The productive system, bereft of the former free price guidance, however perfect or faulty, must be directly controlled as to its technique, volume and timing of investment, choice of goods to be produced, and their volume and quality. The ultimate end toward which such a development tends is a planned economy in which production must be scaled, supplies rationed, priorities established, techniques adjusted, capital channeled, labor mobilized and controlled to put the public's consumption and the business world's system of production in working harmony with the official price structure. Some directive agency as national brain must supervise the beating of the nation's heart, the breathing of the nation's lungs, the functioning of organs of secretion and excretion, and the co-ordination of muscular activity. It is no longer left to the nervous reflexes of price response. While it may be convenient for purposes of business and domestic management to retain the mechanism of money wages and price exchange, this is only

a nominal price system, and administrative convenience rather than a significant factor in economic organization or a vital element in social functioning.

Many, perhaps most, of our citizens would hesitate to embark on so sweeping a program of politico-economic change as is here sketched—all the more since they have witnessed various types and stages of its experimental development abroad. Some of them, in despair over the shortcomings of our present price-and-production situation, look longingly toward partial or complete restoration of the low-level safety of spontaneous price-making under small-scale competition. Others, who feel that such a return to a small-unit system of organization would entail too great a check to technological progress, still believe that economic direction cannot be left to either individuals or groups. They discuss a goal of high-level safety and efficiency conceived in terms of "the general welfare" as formulated by a headquarters staff and effectuated through "the provident state." The milder types of "economic planners" think in terms of merely advisory economic guidance, complementing a system of business operation still predominantly private. The more ardent planners show a clear distrust of the ability of private agencies to function for the public good.

"Parity prices" under the Agricultural Adjustment Act, coal prices under the Bitmuminous Coal Act of 1937, and various minimum wage and rate schedules are fragments of a conceivable system of general authoritarian price-making. With the success of one fixation depending on other prices being brought into consistent relationship, there is discernible in these separate attempts to remedy specific price ills a gathering momentum toward comprehensive price control, and its attendant production and consumption control.

No doubt the faults in our price structure which prompted these regulatory devices were real. Relief of specific difficulties has unquestionably been afforded under some of the regulatory devices applied. But before we commit ourselves to an enlargement of these efforts or elaboration of the parts into an all-embracing plan of economic organization under authoritarian price-making, alternative possibilities should be intensively studied. This turns our attention to the prevailing scheme of price-making in American business. In spite of remnants of automatic price-making and some intrusion of authoritarian price-making, our system is largely in the hands of private businessmen, but with considerable centralization of control over both prices and the productive operations related to them. It is a system of "administered prices" or "monopolistic competition," whether among few or many competitors.

THE DUAL NATURE OF "ADMINISTERED" PRICES

Administered prices, though clearly distinguished from either automatic or authoritarian prices, partake of the nature of both. They are like automatic prices in that producers with great freedom to make whatever product they like on such a scale as they see fit trade in an open market for any price that they find acceptable. Administered prices depart from the theory of automatic price-making in that producers are differentiated as to product, location, or other significant factors and in that the individual concern makes a sufficiently large percentage of its distinctive articles (with attached services) so that it can exercise a price policy and give the policy some degree of force through its control of the volume of output. This ability to administer a block of resources of significant size under an integrated production and price policy gives many large industrial executives a power of control akin to that of a public agency engaged in authoritarian price-making.

On the other hand, price administration by private firms is unlike authoritarian pricing in that the corporate executive must operate within the limits of a price system in which he must pay wages and salaries that will attract the necessary kinds of workers and charge prices which will permit the absorption of his product and maintain earnings which will preserve his capital, provide for its necessary growth, or so fortify his credit rating as to permit necessary borrowings. That is to say, he must face the responsibility for his own acts within the bounds of his company rather than absorb them in a total economy as a political regime may do.

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PRICING AND PRICE POLICIES

R. M. ALT and W. C. BRADFORD

In its sales policies a business company selects the best means for obtaining satisfactory revenues. In the first place, there is the possibility of increasing profits through selecting a more successful product or combination of products, that is, through adding and dropping lines. Resultant changes in "sales mix" are an everyday occurrence in most businesses. The company can also modify and improve existing products with a view to enhancing its sales position. Considerations such as these constitute the company's "product policy." There may also be possibilities of increasing sales through promotional effort, such as advertising. Still other adjustments of sales policies lie in the direction of extending services, such as transportation, credit, and technical assistance to the buyer. Finally, there are the basic possibilities of changing prices and volume of production. All these adjustments have the common objective of increasing or maintaining profits. To some extent the various types of adjustments are alternatives, i.e., one line of action can be chosen in place of another. And to some extent these various moves supplement one another. A company may, for example, elect not only to improve its product but also to spend money in advertising the improvements.

* * * *

THE ECONOMIC THEORY OF PRICE

As it pertains to the pricing operations of an individual firm, economic theory offers an exact solution to the problem of determining price. The business firm is conceived as having ascertainable schedules of demand and cost. The demand curve summarizes the reaction

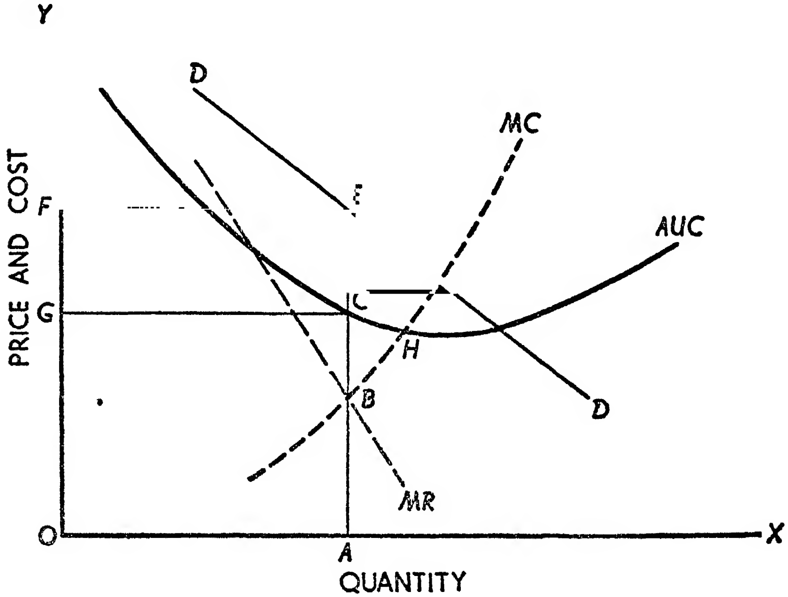
of the market, in terms of quantity taken, to a series of possible prices which the firm might set. It is based on buyers' wants (conditioned, perhaps, by advertising). It reflects as well the existence of substitutes and the relative terms on which these substitutes can be obtained. The firm's cost curve, in all situations except the immediate short run when a stock of goods is to be disposed of, describes the conditions of supply. The costs of different-sized outputs vary, and, in periods long enough to permit their operation, price changes for input factors, changes in technology, and variation in size of plant also affect costs.

MARGINAL ANALYSIS

Since the demand curve presents the schedule of prices at which the firm can sell different quantities on the market, it is the curve of

Exhibit 1

EQUATION OF MARGINAL REVENUE AND MARGINAL COST BY A BUSINESS FIRM



average revenue (total dollar sales ÷ number of units sold). The corresponding cost curve indicates the average costs of producing a unit of product. Both demand and cost can be stated alternatively as mar-

ginal schedules or curves. When the curves are thus presented, they indicate the effect on total revenues and cost of selling (or producing) one more unit of output.

By consulting his marginal curves of revenue and cost, the entrepreneur determines what output he can most advantageously produce and sell. It is the output at which marginal revenue exactly equals marginal cost. To produce more than this amount indicates that the last units add more to total cost than they add to total revenue. To produce less than this amount is to fall into the opposite error, for some expansion of output would then add more to revenue than it would to cost. At no point is the entrepreneur so well off as when marginal revenue is equal to marginal cost. This favorable condition is shown in Exhibit 1.

MARKET STRUCTURE

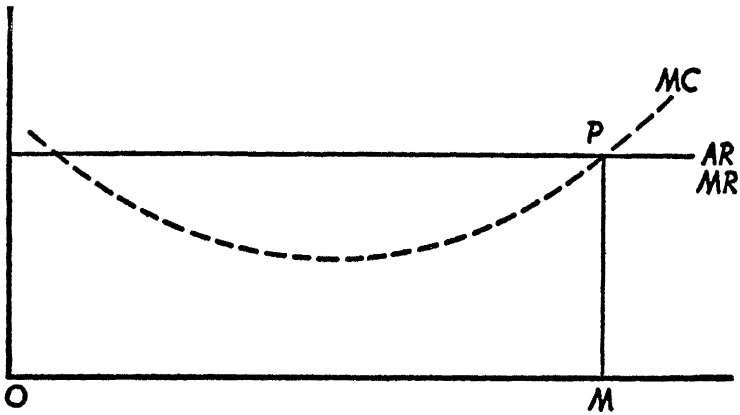
Thus far the conventional theory of price appears to be more a theory of the firm's output. To demonstrate how price can be independently determined by a firm, it is necessary to explain something about the markets in which entrepreneurs sell their products. For convenience, we shall refer simply to three major types of market structure, though economic theory elaborates many other collateral types. The three types are: pure competition, monopolistic competition, and monopoly. Under pure competition there are many sellers and many buyers dealing in a more or less standardized commodity. So far as the commodity or conditions of sale are concerned, no buyer has any reason to prefer the product of one seller over that of another. And, because each seller produces a small part of the total output which comes to market, he cannot influence the market price. The impersonal forces of aggregate supply and demand determine the market price which the individual seller accepts as given. His only possible adjustment, therefore, is to expand his output up to the point where marginal cost equals the marginal revenue derived from the product. And in this case marginal revenue is the same as the market price. Equilibrium of the firm under pure competition is shown in Exhibit 2.

The monopolist has sole control of a product for which there are no close substitutes; in other words, he controls the entire market supply. Quite obviously, the amount of output which he places on the market will have a major effect on price. He also identifies his demand curve with the market demand curve. Thus the monopolist, unlike the seller in pure competition, has two alternatives: he can control the amount of output which he places on the market (and this affects

price), and, having a less than perfectly elastic demand curve, he can set a price for his product. The monopolist, however, like the pure competitor, achieves the greatest net return by equating marginal cost and marginal revenue. The same reasoning applies. The fact that the monopolist has a negatively inclined demand curve leads to the equalizing of marginal revenue and marginal cost at a point on the vertical scale which is less than price (in Exhibit 1, *AB* is less than

Exhibit 2

EQUILIBRIUM OF FIRM UNDER PURE COMPETITION



AE). In pure competition, by contrast, not only were marginal cost and marginal revenue equal, but they also equaled price (see Exhibit 2).

Finally, between the logical extremes of monopoly and pure competition fall most of the actual market structures of the business world. In these markets sellers are described as being in monopolistic competition because each has certain distinctive products which lead buyers to favor him in preference to other sellers, and yet the *differentiated* products of these sellers are reasonably good substitutes for one another. Sellers in this market possess limited monopolies of their products, and the preferences they enjoy may be ephemeral, in that they depend on reiterated advertising appeal, etc., which will tend to be matched after a lapse of time by other sellers.

Both monopolists and monopolistic competitors generally follow the practice of setting the prices for their products before putting them on sale. They are then prepared to sell all that the market will take at the predetermined price. For the most part, theirs is a problem of price policy rather than of output policy.

PRICE POLICY

The foregoing paragraphs state in somewhat abbreviated form the marginal analysis of economic theory as it applies to pricing by the firm. It is a matter of long-standing debate among economists as to the extent to which business behavior conforms to the logical outlines of marginal theory. The consensus seems to indicate that businessmen generally lack the precise knowledge of demand and cost which theorists impute to them. There is also some question whether the simplified logical models of economic theory represent accurately the complex mechanisms of the business world. Our interest in applying economic analysis to business situations compels recognition of the fact that businessmen, at least in the first instance, deal, not with demand curves and cost curves in determining prices, but with numerous special conditions of the market in which they sell their products. These conditions are of two sorts: those pertaining to the internal organization of the firm and those relating to the external structure of the markets in which the firm operates. Before examining these conditions, we turn to a preliminary consideration of the meaning of price policy.

MEANING OF PRICE POLICY

> To say that a businessman has a price policy necessarily means that he has some degree of latitude in determining the prices of the commodities he has to sell (or perhaps those he wants to buy). In many sections of the economy, of course, no such latitude exists. The farmer, as an individual, for example, can have no price policy with regard to the wheat or cotton he produces. He is so insignificant a factor in the total market that he must simply accept the price as he finds it. . . . In the case of most manufactured products and some raw materials . . . the individual businessman can exercise some discretion in determining the price of his wares. The manufacturer of steel, of automobiles, of corn flakes, or of proprietary drugs has a very real voice in deciding the price at which he will sell. The extent of this discretion varies widely; it is generally, though not necessarily, greater where competing sellers are few than where they are many. [*T.N.E.C. Monograph No. 1,* Gov't Printing Office, 1940, p. 4.]

As a result of this command over price, one of the important functions of business management is the adoption of general pricing rules, i.e., price policies which improve the market position of the firm. . . . Price policy indicates the determination of price through reference to a broader set of considerations than is ordinarily understood by cost

and demand conditions. The significant pricing activities of a businessman relate to his selection of a price policy; actual price setting is likely to be an administrative action which carries out the policy previously adopted.

INTERNAL ORGANIZATION AS A DETERMINANT OF PRICE POLICY

How a company is organized has an important bearing on the price policies it selects. Control over prices is frequently distributed within the firm among several levels of authority. Top management often makes the key pricing decisions, that is, the changes in base prices. Subordinates carry out the complex task of administering discounts, extras, and other terms which constitute the firm's price structure. In June, 1936, when the Interstate Commerce Commission required the eastern railroads to effect a general reduction in their base prices from 3.6 cents per mile to 3.0 and 2.0 cents for Pullman and coach, respectively, this was a top-management decision (actually, it was forced on management). Implementation of this reduction in base price was the work of the passenger rate-making divisions of the railroads, which had to recalculate thousands of point-to-point fares. Because of rate equalization and other irregularities in railway rate structures, the general cut in the basic rate could not be applied uniformly across the board. Thus the impact of price policy made at the top filtered through the organization as particular details of price administration were handled at lower levels. Among other effects, the very elaborateness of the administrative process in setting and resetting prices may deter management from making frequent changes. Such a result seems highly probable where companies have published catalogues and where price lists have been distributed to customers.

This suggests the possibility that another feature of internal organization, namely, the planning period, may have a major influence on the selection of price policies. Businessmen as well as economists distinguish between decisions made with reference to the long run and those which look only to the short run. The planning period, whether long or short, determines the considerations which enter into the selection of a price policy. The planning period may be thought of as "the length of time within which the anticipated results on the firm's revenues and costs that motivate a decision are exhausted." The length of this period varies from industry to industry and from firm to firm. In retail trade it is customary to plan merchandising operations (purchasing, financing of inventories, sales planning) by

six-month periods. Although individual prices are subject to change more frequently, the general level of prices within a six-month season tends to hover around the planned mark-up for the period. In the automobile industry, on the other hand, the model year is the usual planning period. The sale of a promotional lot which a department store picks up in the market indicates a short-term price decision. On the other hand, long-run price decisions arise when a new product is introduced, when channels of distribution are changed, and when a new price line is adopted.

Other aspects of internal organization also account for the selection of particular price policies. An intangible but highly influential factor is the personal outlook of the entrepreneur where a single individual holds a position of great power in a large corporation. Price policies in the early days of the automobile industry were in no small degree traceable to the insistence on low prices and mass distribution by Henry Ford. Price cutting in the rubber tire industry, where a small number of large firms dominates, may have resulted from the personal influence of Firestone. Recently the position of the Great Atlantic and Pacific Tea Company has exerted a downward pressure on retail food prices, and this may be traceable to the personal outlook of Mr. John Hartford.

MARKET STRUCTURE AS A DETERMINANT OF PRICE POLICY

The conditions of competition which prevail in the market directly affect the price policies which business companies select. The nature of competition, in turn, is determined by the institutional structure of the market. Economists, in developing this explanation of competition, are accustomed to classify market structures primarily with regard to the numbers of sellers and buyers in these markets and with regard to the degree of differentiation of the product. These characteristics of market structure are obviously among the most important factors governing the firm's selection of price policies, but in the discussion which follows we shall refer, as well, to other aspects of market situations.

When a large number of sellers and buyers is active in a market and when no one firm is so large as to dominate, no individual company is able to pursue a price policy; the market price, determined by the interaction of the large numbers on either side, governs. Only in the limited sense of staying out of the market or of buying or selling more heavily than current requirements can a firm have a price policy (this might more properly be called a "volume" policy).

The case is different where one or a small number of firms constitutes the whole market. The influence of the individual firm's price on the market price is then evident. With a small number of firms, a price policy—some consistent line of action—is necessary. But, even under these conditions, if firms are of different size, smaller firms may find that they can enforce no price policy of their own. Sooner or later it becomes evident that it is to their interest to adopt the prices set by larger firms. Thus not only numbers but size of firms determines the character of price policies.

Whether there are numerous and close substitutes has an important bearing on the price policies adopted by business companies. Prior to 1941 the Aluminum Company of America was the only producer of aluminum ingot in the United States. As a monopolist, the company could have set higher prices than it actually did. There is some evidence to show that in the twenties the company held aluminum prices low enough to discourage production of other light-metal substitutes. In industries where there is more than one producer, the several competitors, in an effort to escape price competition, may differentiate their products. Especially in consumer goods, differentiation of products is widespread. This is accomplished by branding, packaging, design, and technical distinctions, and the differences (in the consumer's mind) are emphasized by advertising. A Chevrolet is not an exact substitute for a Ford, and yet, despite the limited protection afforded by differentiation, these automobiles are very definitely in competition with each other.

Aside from differentiation, other aspects of the product have a marked effect on price policies. A consumer good is likely to require a different price policy from an industrial good. In the one case buyers are numerous, relatively uninformed, household consumers; in the latter they are predominantly skilled purchasing agents, primarily concerned with the technical properties of the product. Durable goods, whether consumer or industrial, are also likely to require different price policies from nondurables and industrial supply items. These latter are purchased from day to day and week to week and are generally in more elastic demand than durables.

Other aspects of market structure, significant in the selection of price policies, include distributive channels. In a general way, the longer the distributive chain, the less flexibility there is likely to be found in price policies. A packer of frozen foods announced price reductions of 2–7 cents a package and simultaneously eliminated wholesalers from his distribution channels.

Various aspects of cost have an important bearing on price policies. The degree of current control of production, i.e., the length of

the production period, may determine how rapidly changes in raw material and labor cost affect final prices. The manner in which unit costs vary with different sizes of plant may also affect the price policies of different companies. Variations in cost resulting from short-run fluctuations in output can influence price policies. In this connection it is interesting to note that the automobile companies, which accept the model year as their planning period, take no cognizance in price policy of short-term fluctuations in the rate of production. It is difficult to see how they could.

This by no means exhausts the list of market phenomena which influence price policy. It is probable that the age of an industry has something to do with its pricing policies. It is not simply that the older industries tend to be more conservative in outlook; there seems to be also the very real problem, especially in durables, of market saturation. The electric refrigerator industry, which experienced very little decline in the depression of 1932–33, found that the change to a replacement market necessitated different price policies following the depression of 1937–38. Other aspects of market structure exerting strong influence are customary prices and price differentials. Price in some markets becomes so identified with a certain level that adjustments cease to be made in price policy. In retail trade, price lines sometimes remain unchanged for years. The full impact of adjustment then falls upon product variation, advertising, and other forms of nonprice competition. Another dimension of market structure significant for price policy is the existence of patents, trade-marks, and other legalized restraints on competition. Because these confer partial monopolies on the seller, prices in these markets are frequently stabilized on the short run.

Finally, the presence of governmental control over conditions of competition sets limits for the exercise of price policy. It is highly probable that the anti-trust activities of the government have led to the development of certain price policies which might otherwise not have appeared. In the absence of legal barriers to price agreements, there seems little reason to doubt that many industries would have found it convenient to follow the practice, sanctioned abroad, of forming cartels openly. Government action has also influenced the price policies of business companies through resale price maintenance and unfair practice laws. Even where certain products have not been "fair-traded," there is reason to believe that the nature of the markets in which they are sold has been affected by the presence of numerous competing products which are legally price-maintained. The packaged liquor market in New York State, after passage of the Feld-Crawford Act (resale price maintenance) presents an example of the effects of

governmental control on the prices of consumers' goods. Perhaps no single piece of legislation has more directly affected business price policies than has the Robinson-Patman Act, passed in 1936, which forbids price discrimination on the part of sellers among buyers. The aim was to place large and small buyers on the same footing, so far as price was concerned.

SOME TYPES OF PRICE POLICIES

* * * *

PRICE AGREEMENTS

Under some conditions of market structure, business companies have acted in concert to establish uniform market prices. Although many price policies attempt to accomplish this objective through indirect methods, there are two conditions under which price conventions operate to set price directly: (1) where the number of sellers is small enough to permit easy control of price and (2) where government intervention has provided the framework for large numbers of sellers to adopt a common price.

Agreements among a few sellers who set prices for their industry are prohibited by law as conspiracies in restraint of trade. Despite the illegality of such action, price agreements have frequently been made in industries where conditions are favorable to this end. The government, through the Federal Trade Commission and the Department of Justice, has sought to bring such agreements to light and prosecute the parties under the anti-trust laws. It is probable, however, that price agreements are far more numerous than published information would indicate.

Increasingly, business companies are looking to the government not only to permit price agreements among sellers but also to supply enforcement machinery. A striking example of this sort of price-agreement technique was found under the N.R.A. codes. . . . Only twelve of these codes, however, empowered the code authority to establish minimum prices without reference to cost of production. The most important codes permitting direct setting of prices were those in the bituminous coal, lumber, and petroleum industries. The immediate result was an abrupt rise in prices in these industries. . . . Because of the difficulties of enforcement and lack of general agreement as to the desirability of prices set by the code authority, there was widespread evasion. In the case of the coal industry, subsequent legislation attempted to carry on industry-wide price-making after the N.R.A. was declared unconstitutional.

PRICE LEADERSHIP

Price leadership is a practice in which most units of an industry adopt the price announced by one member of the industry. Ordinarily, this member is the largest firm in the industry. The United States Steel Corporation, for example, is the acknowledged price leader in the steel industry.

Exact following of the price leader by all firms in the industry is rarely found. Occasionally other firms may initiate price changes, and there may be lags in adjusting prices to those of the leader. When demand is strong and sales are at a high level, there may be more disposition to follow the leader than when demand is weak and sales are declining. In the latter case, temptation to cut price is strong. Leadership is usually more carefully followed when price is reduced than when price is advanced, but this also depends on general market conditions. In the postwar period, for example, the smaller manufacturers of motor cars placed their prices at higher levels than did the Big Three.

The largest firm assumes leadership because of its recognized influence on the market price. Its financial resources and large productive capacity enable it to enforce leadership. Other members of the industry may also look to the leader for guidance in pricing because the dominant firm is expected to have better knowledge of costs of production and marketing.

PRICE STABILIZATION

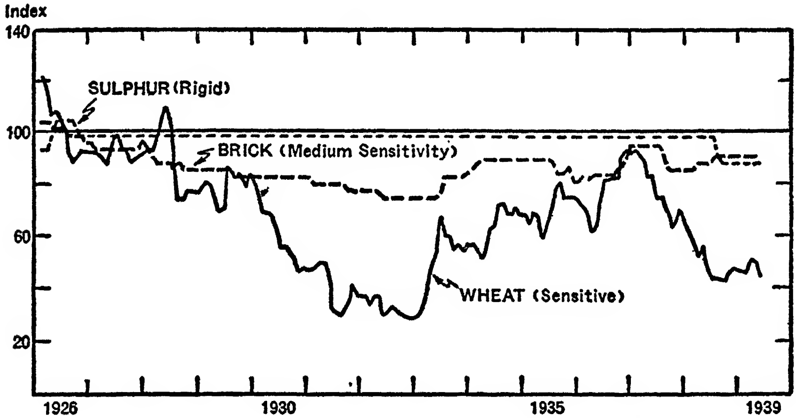
Price stabilization relates to the behavior of prices over time. Prices which are stable change little; complete stability means absence of all change. But, obviously, all prices change somewhat, given a sufficient lapse of time. Price stabilization, therefore, is a relative term; some prices are more stable than others. During the depression of 1929–33, for example, prices of copper and hides declined over 70 per cent. Prices of agricultural implements and anthracite coal, on the other hand, declined hardly at all. The latter are stabilized, inflexible, or insensitive prices; the former are flexible or sensitive prices.

Changes in price can be grouped into four categories: casual variation, seasonal variation, cyclical change, and secular trend. The first is characterized by irregular movement, follows no pattern, and is unrelated to the general price level. The second offers a recurrent pattern of variation with annual periodicity. The third follows broad swings of the general price level in periods of prosperity and depression, while the fourth shows a persistent, long-term movement of its

own, independent of the general price level. . . . The price policies of business companies can have to do with any of these types of price movements, but the policy of price stabilization is peculiarly significant in considering cyclical movements of prices. A contrast of stabilized and non-stabilized prices is shown in Exhibit 3.

Exhibit 3

SENSITIVE AND INSENSITIVE PRICES, 1926–39
(1926 = 100)



Source: *T. N. E. C. Monograph No. 1,* p. 24. These index numbers are based on averages of quotations secured as of one day each week.

There are three common statistical measures of stability: the *frequency* of change in the price of an item, the *amplitude* of change (i.e., how high and low price swings), and the *timing* of price change (i.e., whether a given series leads or lags other series). It has also been suggested that the response of prices to cost is of basic importance in the study of price flexibility. For example, some industries are so organized that they tend to pass on rapidly, by means of price deductions, the benefits of cost reductions achieved through technologic advance; others are slow to do so.

* * * *

The market conditions which permit stabilization of prices are of many sorts. The fact that in many companies prices are set for a season, a model year, or other selling period increases stability. Similarly, some commodities, such as steel, are sold under long-term contracts, reducing the number of transactions. Others are sold with

guarantees against price declines—a stabilizing factor. Prices are also likely to be stable in industries where trade associations are strong or where the number of sellers is small. In the latter the existence of price leadership encourages stability of price.

* * * *

PRICE CUTTING

A firm engages in price cutting when it reduces the price of an article below the level at which other firms are selling the same or similar goods. Strictly, any departure from a uniform market level would be regarded as price cutting under the terms of this definition. But it is customary in many industries and trades for different firms to preserve recognized differentials. Supermarkets, for example, usually sell the same goods at lower retail prices than do small service stores. These price differentials are part of the regular market structure and are not ordinarily considered price cuts.

Business companies cut prices for several reasons. In the first place, price cutting, even under pure competition, is the method by which adjustments are made to changes in cost and demand. Someone must initiate the cut. Second, firms find a temporary advantage in price cutting as a way of securing a place in the market. Thus, a new retail store may reduce prices below the going level in order to build up a clientele. A third form of price cutting involves the use of leaders. The prices on one or a few items are cut in the hope of attracting sales, either for these or other items in the line. Finally, there is predatory price cutting which aims, by price reductions, to destroy the business of competitors. A related tactic in pricing is the disciplinary price cut invoked by a price leader to bring into line a smaller firm which has broken the established price.

DIFFERENTIAL PRICING

In many business situations the price of a product is not a simple, unequivocal fact. In industrial pricing it is necessary to distinguish the *base price* from the *price structure*. The latter represents the system of differentials or departures from base price. In the steel industry, for example, there is a base price quoted for steel of a certain dimension. Added to the base price are *extras,* which apply to certain shapes and sizes of the product. In the same manner, steel of superior chemical composition calls for "quality extras." The relationship of base price to price structure varies greatly among industries. Frequently, the differentials in price are associated with differing quantities purchased, in which case they are called "quantity discounts." At other times the

trade status of the buyer may give rise to different "trade discounts." Thus chains and mail-order houses may be given discounts off the base or list price which are different from those given wholesalers. (Under the Robinson-Patman Act preferential discounts may legally be granted only when based on difference in cost or when the effect is not materially to lessen competition.) Other differentials in the price structure may be introduced through cash discounts, freight allowances, seasonal discounts, advertising and promotional allowances, trade-ins, price guarantees, various credit terms, and discounts for early acceptance of delivery. The net price may also be effectively modified by use of guarantees of performance and quality, by extension of legal and other services, by agreements for exclusive dealerships, and in other ways which are not directly measurable in dollars and cents.

The importance of the distinction between base price and price structure is twofold: (1) there is a tendency for announced price variations to be made in terms of base price rather than in price structure, the latter remaining fixed for long periods of time, and (2) when prices soften, net prices to buyers will often be reduced by secret concessions within the price structure, base prices remaining unchanged. From the standpoint of management the distinction between base price and price structure is also important because it gives the firm additional means of adjusting its prices to the markets it serves.

The occasions for price differentials are numerous; many price structures are designed to provide prices not only for identical products sold under differing conditions or in differing amounts but for nonidentical products which are related in demand. Some of the pricing problems which give rise to price differentials have been classified by Professor Dean [Joel Dean, "Cost Forecasting and Price Policy," *Journal of Marketing,* Vol. XIII, January 1949, p. 286] as follows:

Types of Differential	*Example*
Quality differentials	Standard versus de luxe models Regular versus "fighting" brands
Size spreads	3-ton versus 5-ton trucks
Use differentials	Royalty leasing of patents and machinery Fluid milk versus cheese milk
Load-factor differentials	Morning movie prices Off-peak electric rates
Style cycle progressions	Merchandise mark-downs Edition differentials

Types of Differential	*Example*
Trial discounts	Introductory subscriptions to magazines and to services
Quantity discounts	Order-size discounts Package-size differentials
Distribution channel differentials	Wholesale versus retail prices Private brand versus house brand
Geographical differentials	Zone pricing Basing-point pricing

The criteria for setting price differentials are based, as in the case of other price policies, on the characteristics of market structure. Dean discusses these as follows:

> *Product Line Pricing.* The problem is to fix the relationships of prices among your products. What kinds of products need to be priced in relationship? What kinds independently? In principle, only products whose demands are importantly interrelated must be considered together in pricing. Relationship on the cost side, through common production of distribution processes, has no bearing here. Common costs reduce the accuracy of estimates of the costs of individual products, but should not affect the relation of product prices. Joint products should be priced independently unless they are related in demand. Demand interdependence includes products that are similar in use and hence are potential fringe substitutes, or products that complement one another in use or in the sellers' market-strategy.
>
> A common way of setting the price of such kindred products is to estimate the full costs, including overheads, of each and apply a uniform percentage mark-up. This is easy and definite, but it is usually not the best way to go about it. The various qualities, sizes, editions, etc., of the product are likely to tap market sectors differing in demand elasticity and in competitive intensity. These demand differences should be the controlling determination of price differences.
>
> A constructive approach to problems of this type is to view the product variants as opportunities for market segmentation in order to tap added markets and to separate sectors of the market which differ in demand elasticity. For example, multiple editions of books are a means of successively exploiting more and more elastic sectors of the market. Viewed thus the technical problem of product line pricing is to obtain the most profitable degree and kind of price discrimination.
>
> Relevant considerations for setting product differentials include: (1) Relative buyer-benefits obtained from the product variants (i.e., the use value in different applications and sections of the market). (2)

Degree of competitive superiority of your product. (3) Intensity of competition. (4) Comparative elasticity of demand of the market segments tapped by each product. (5) Cross elasticity of demand among your products. (6) Future revenue consequences upon customer good-will. (Prices that are proportional to sellers' allocated costs are sometimes thought to have magical effects upon buyers' good-will.) (7) Promotional effects of introductory model pricing (e.g., loss leaders, introductory subscriptions, equipment subsidies to stimulate sales of parts). (8) Effects upon profits of alternative schedules of differentials best studied by effects on total contribution to overhead and profits.

From this list it is apparent that the role of cost estimates in product line pricing should be a secondary one. Their most important job is to help project the earnings consequences of contemplated product differentials. Estimates of total cost before and after, paired with comparable estimates of total receipts, are needed for this job. The impacts upon total costs of more sales or of less sales of the various products can often be most practically projected by using the incremental cost of the various products.

Incremental cost has other important uses here. It can be used as a bench mark for finding the best pattern of market segmentation and price discrimination. The spread between incremental cost and price represents the product's contribution to overhead and profits. This spread should be studied in measuring the profit effects of alternative prices and in deciding upon product additions and product deletions. Hence incremental costs play a strategic role in maximizing this marginal contribution by price structure decisions.

Where common overhead costs are important, increment costs can often be approximated by using traceable costs. The allocation of overhead costs to individual products is quite arbitrary and is subject to wide errors; moreover many of the overhead items may not vary with output and hence have no short-run marginal cost. Orthodox allocations are often more misleading than useful in estimating incremental costs. This approach does not imply that prices should be *equal* to incremental costs—far from it. Nor does it mean that prices of related products should be *proportionate* to their marginal costs. The margin between price and incremental cost should normally differ among related products. And these differences should not be determined by the theology of cost accounting. Instead they should be governed by the demand and competitive considerations cited above. Thus, estimated incremental cost is a practical economic sill—it sets the minimum of bed rock pricings, it serves as a valid point of departure for demand pricing and provides an efficient vehicle for tracing effects on total costs and profits.

Cost estimates sometimes have still another function in product price differentials. A study of the comparative costs of various kinds of users gives a clue to the use value and buyers' benefits of producers goods.

Royalty licensing represents in some respects a sort of ideal of market segmentation pricing that is keyed to user costs and user benefits and is admirably divorced from irrelevant sellers' costs.

Quantity Discounts. A sound quantity discount policy requires estimates of the relationship of your cost to the relevant dimensions of quantity. The Robinson-Patman Act is construed as limiting quantity discounts to the savings of the seller (although it makes an exception "to meet competition"). Key questions in studying this relationship include: Does cost vary more closely with account size (i.e., the volume of annual purchases), or with the size of the individual order? How big are the savings of case lots?

Many prewar cost analyses now badly distort the present and future cost relationships. The universality of the unprofitable small customer problem (e.g., 80 per cent of the customers accounting for 20 per cent of the volume and 10 per cent of the profits) may indicate that many quantity discount structures need a check-up. Possibly price has not been adequately used as an instrument of selective selling.

Cost estimates should not *determine* the quantity discount structure; instead they should be used: (1) to help select the *basis* of discounts that is appropriate for your business (e.g., annual sales or order size); (2) to mark out legal limits for the amount of discounts; (3) to estimate the impact on your profits of adopting alternative schedules of quantity discounts. [*Ibid.*, pp. 286–288]

Economic theory treats market segmentation as a technical problem of price discrimination. Where it is possible to distinguish different classes of buyers within a total market and where these classes have different elasticities of demand, it is worth while for a seller to charge different prices for the same product. This assumes that there will not be an undue amount of transference of buyers or resale of product from the less-favored to the more-favored market. The wall of market segmentation can be built higher by differentiating what is basically the same product. The differentiation (e.g., through labeling, packaging, etc.) may or may not involve cost differences.

The legal meaning of price discrimination does not correspond at all points, however, to the economic concept. As represented in the Robinson-Patman Act, discriminatory prices are those which vary, for different buyers, by more than the costs involved in production and sale to these buyers. No legal discrimination is involved if the buyers are not in direct competition with one another.

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SUBSIDIES AND FOOD PRICES

THE COUNCIL OF ECONOMIC ADVISERS

THE MAJOR FUNCTION of price in a free economy is to induce the production of the goods desired by the people, in the volume they demand and are willing to pay for. When, as at present, circumstances require that prices be put under control, one of the major principles determining price policy is the achievement of maximum production, particularly of goods most needed for the defense program. Another method of stimulating production, which is an alternative to higher prices, is for the Government to pay the producer a subsidy in addition to the price he receives from his customers. The funds to pay subsidies come out of Government revenues, that is, out of taxes instead of out of prices. In some kinds of situations, the granting of subsidies is preferable as a production stimulant to permitting price increases, while in other kinds of situations subsidies are undesirable.

The clear occasion for the use of subsidies to induce needed production is where it is necessary to secure supplies from high-cost sources of production, which will not respond to the price offer which is bringing the bulk of the needed output into the market. Where the high-cost producer can be clearly identified, and it is therefore possible to determine the differential in price which is required to cover his extra cost, the subsidy payment is not only permissible, but it is an excellent method to obtain additional supplies. If a market price of $1.00 per unit is high enough to lead to the production and sale of 1 million units of a necessary commodity, but the production of an additional 100,000 units would require a price of $1.25, there is no justification in a period of emergency for permitting a demand for 1,100,000 units to bring about a market price of $1.25 for the entire supply, if it is possible to pay the extra 25 cents only to those who are burdened by the higher cost.

The need for use of subsidies to minimize market price increases becomes more acute as the pressure of demand upon scarce supplies builds up, and as increasingly high-cost sources of additional supply have to be tapped.

The principle of differential subsidies to marginal supplies is particularly applicable, and it should be applied freely, in the case of minerals. High-cost mines can be brought into production in most mining fields if a higher price is paid. Current output, yielding a satisfactory profit at current prices, will continue without an increase in price, and the mine operator should not be given windfall profits because the national need for additional supplies in an emergency period compels the payment of higher prices for additional supplies. The high-cost production can be identified, the amount of additional payment therefor can be determined, and it should be paid in the form of a subsidy while the general market price is held.

The same policy is proper in the case of imported commodities, both minerals and other goods. Where higher-cost imported goods must supplement the domestic supply of the same commodities in order to meet essential requirements, the domestic price should be held and subsidies in the necessary amount should be paid to the importer. The high-cost supplier is, in such a case, easily identified, and the necessary differential is readily determined. The policy may well be extended further with respect to some imported goods, where they constitute the entire supply and are important elements of cost. In order to limit the effect upon the cost of domestic production into which foreign materials enter, it is sound policy in some cases for the Government to fix a low price on the sale of imported materials and to absorb the loss. These policies were applied in many cases during World War II.

The question has also arisen as to whether subsidies should now be used generally to hold down the price of food, by making payments to farmers in lieu of price increases which otherwise might be necessary to obtain an adequate volume of farm production.

First of all in this connection, it is necessary to say something about farm prices and incomes in general, and about the national policy of farm parity and farm price supports.

There has been some tendency in recent years to misinterpret the trend of farm prices and farm incomes. Farm prices are more volatile than many other prices, and respond more sensitively to market changes. While they have at times moved upward more rapidly than other prices, they tend to move downward much more rapidly whenever any softening occurs in the general economic situation. Farm income declined much more rapidly than other major incomes in the

1949 recession, and even though farm income has risen substantially in the past year, a case can hardly be made that, by sound criteria, farm income as a whole is high in comparison with other incomes, although there are exceptions in the case of some farm commodities.

This being the case, there would seem to be no reason to tamper fundamentally with the parity principle, even in the course of the stabilization effort. Even in that effort, a fair relationship among groups should be maintained, and the parity principle does not operate to confer unjust benefits upon farmers as a whole.

Insofar as farm prices rise above parity, they can be subjected to controls the same as other prices, except where this is prevented by special legislation. The Council does not favor such special exemptions.

This brings us to the view that the maintenance of the parity principle, and of the customary farm price support program, is not inconsistent with effective stabilization on a fair basis. Parity prices of farm products rise and fall with the index of prices paid by farmers. If nonfarm prices are held, the parity index can rise only to the extent that there are increases in prices of feeds and other farm products bought by farmers. Insofar as the price of food to the consumer is determined by many other factors besides the price paid to the farmer, the effort to stabilize the consumer's food prices cannot be limited to a consideration of farm prices.

Since the stabilization effort should be permitted to control farm prices when they shoot above parity, the only sound basis for refraining from such control would be if higher prices are necessary to stimulate an adequate volume of farm production. The case for subsidies, therefore, must rest on the ground that it is better to hold the farm price line and pay subsidies to stimulate the needed production. There was such a program of food subsidies during World War II, applying particularly to meat and dairy products, which involved payments of about 4 billion dollars. The rationale of this program was that it was necessary to prevent the spiralling effect upon wages and other costs of production if higher prices were paid for these food commodities in order to bring about the necessary volume of supplies. The record made a good case for the argument that the cost of food subsidies was very much less than the cost in higher prices to consumers would have been, if market prices had been relied upon to bring forth the necessary goods.

However, a uniform subsidy, paid to all producers of a commodity in general use, should not be hastily substituted for a rise in price as an incentive to adequate production for a period of partial mobilization as long as now is in contemplation. It is more appropriate to an emergency situation of seemingly more defined length, and when the

pressure on supplies is more similar to the World War II situation than is now the case.

At this time, it would not be prudent to embark upon a program to pay general food subsidies. There is now no marked deficiency in the supply of foods. The necessary increase in food production requires the liberal fulfillment of the needs of farmers for machinery, fertilizer, and labor. Supplying these needs, which we have ranked as equal with any of the demands of the defense program, is under present circumstances sounder than a general program of subsidy payment. Under changed circumstances, it would be appropriate to consider general food subsidies. The Council's analysis points to the danger of renewed and increased inflationary pressures. The recent floods are a reminder that food supplies are never certain. As the President said in his Message of April 26 to the Congress: "If we find that we cannot hold the line on food prices with powers recommended here, we shall need to consider legislation authorizing the use of other devices, including limited food subsidies, to prevent necessary price increases from being reflected in rises in the cost of living."

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THE NATURE OF MARKETING

PAUL D. CONVERSE and HARVEY W. HUEGY

MARKETING, IN A BROAD SENSE, covers those business activities that have to do with the creation of place, time, and possession utilities. To the economist, then, marketing is a part of production. However, the businessman speaks of marketing as distribution. By distribution he means the transportation of the goods from the point of production to the consumers and all the transactions involved in getting goods from the producer to the consumers.

Marketing is the business of buying and selling. "Marketing includes those business activities involved in the flow of goods and services from production to consumption."

A *market* has several aspects, and the word has at various times been given different meanings. It has been thought of as a *meeting* of people for buying and selling; as a *place* where goods are offered for sale and where buyers and sellers meet; as an *area* within which price-determining influences (supply and demand) operate; as an *area* in which there is a demand for goods. A market is composed of people, but people buy different things; most people buy food and clothing, but only textile manufacturers buy spindles and looms. The area composing a market may be widened by improvements in transportation facilities. The size of the market, or the volume of goods that will be purchased, may be enlarged by an increase in the population or by an increase in the income of the people within the area. . . .

The object of marketing, as of all productive activities, is to supply human wants. People do not eat bread to give the farmer a market for his wheat, but wheat is grown because there is a demand for it from consumers. Steel is not made for fun, but to fill a demand for tools, machinery, railroads, automobiles, and so forth. The object of all business is to give the consumers the goods and services they demand. The incentive and reward to the businessman (entrepreneur) is profit.

Human wants are susceptible to almost unlimited expansion. There are not only the primary wants for food, shelter, and clothing, but secondary wants depending upon man's memory, imagination, and reason. These secondary wants are limited only by the time people have for consumption and by the limited mental powers and characteristics of different individuals. In any but a very simple society, business is called into use to satisfy the great majority of wants. As human wants are almost unlimited, business is capable of almost indefinite expansion.

Using the terminology of the businessman, business is divided into two parts: production (or form utilities) and market distribution. Manufacturers, miners, and farmers have two major problems to consider: first, the production of goods, and second, the sale of goods. Production deals with goods until they are in the warehouse, tipple, or granary, and marketing deals with goods from this point until they have finally been placed in the hands of the consumer.

Much more attention has been given to efficiency of production than to efficiency of market distribution. Production has been studied for generations, thousands of labor-saving devices have been invented,

and mechanical power has been applied in hundreds of ways to increase output. There are mechanical engineers, mining engineers, civil engineers, and chemical engineers. Agriculture is now a science, and dozens of colleges and hundreds of papers are instructing the farmers as to methods of increasing production or decreasing costs. Yet, until comparatively recent years, little critical or serious attention has been given to the study of market distribution.

Market distribution is fully as important as production. Many studies have been made which show that marketing takes 50 per cent or more of what the consumer pays for goods. If marketing makes up half, or more, of the costs, it seems that it deserves as much study and attention as the production of goods. The man who reduces marketing costs is contributing as much to raising the standard of living as the man who reduces production costs by inventing a new machine or by increasing productive efficiency on the farm or in the factory. One of our leading merchants said that, regardless of how much money he made, he would consider his business life a failure unless he reduced the cost of marketing merchandise.

PART FIVE

Distribution

THIS PART BEGINS with David Ricardo's classic statement on rent (73). Henry George's "true" remedy is stated in Selection 74, and is offered here to show the nature of his thinking rather than the content of his book. Number 75, the *Report on Wage Policy* prepared by Robert A. Nathan Associates, is included in the form of conclusions. Although it was prepared in 1947, before the outbreak of the Korean War, it has great significance because it represents the first economic analysis, on a national scale, of labor's demand for higher wages and the feasibility of such an increase. The original *Report,* in addition to fourteen pages of text, includes twenty-eight supporting tables and charts. The present selection should be read with Sumner Slichter's analysis (76), which, in a sense, outlines the *Report* but goes far beyond the specific issues in the way of broad economic analysis. J. M. Keynes is quoted in Number 77 on the propensity to consume. In Number 78, Harold G. Moulton considers income distribution, saving, and economic progress. The nature and importance of capital and interest is discussed by Frank Knight in Number 79. The nature of profits is explained by Joseph A. Schumpeter (80), and their importance, by Fred Rogers Fairchild (81).

Other selections which might be read in connection with this Part are 87, 94, 151, and 156.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged below.

(73) Ricardo, David, *The Principles of Political Economy and Taxation,* Everyman ed., Dutton, 1933, pp. 33–39.

(74) George, Henry, *Progress and Poverty,* Doubleday, 1923, pp. 326–328.

(75) *A National Wage Policy for 1947,* analysis prepared for the Congress of Industrial Organizations, Washington: Robert R. Nathan Associates, December 1946.

(76) Slichter, Sumner, *An Answer to the Nathan Report,* Bank of New York, January 10, 1947.

(77) Keynes, J. M., *The General Theory of Employment, Interest, and Money,* Harcourt, Brace, 1935, pp. 96–98, 104–106.

(78) Moulton, H. G., *Controlling Factors in Economic Development,* The Brookings Institution, 1949, pp. 103, 125–138.

(79) Knight, Frank, *Readings in the Theory of Income Distribution,* Blakiston, 1946, pp. 384, 387–390, 393, 394–398, 407.

(80) Schumpeter, J. A., *The Theory of Economic Development,* Harvard University Press, 1934, pp. 153–154.

(81) Fairchild, F. R., *Profits and the Ability to Pay Wages,* Irvington-on-Hudson, New York: Foundation for Economic Education, 1946, pp. 36–39.

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RENT

DAVID RICARDO

RENT IS THAT PORTION OF THE PRODUCE OF THE EARTH which is paid to the landlord for the use of the original and indestructible powers of the soil. It is often, however, confounded with the interest and profit of capital, and in popular language, the landlord. If, of two adjoining farms of the same extent, and of the same natural fertility, one had all the conveniences of farm buildings, and, besides, were properly drained and manured, and advantageously divided by hedges, fences, and walls, while the other had none of these advantages, more remuneration would naturally be paid for the use of one than for the use of the other; yet in both cases this remuneration would be called rent. But it is evident that a portion only of the money annually to be paid for the improved farm would be given for the original and indestructible powers of the soil; the other portion would be paid for the use of the capital which had been employed in ameliorating the quality of the land, and in erecting such buildings as were necessary to secure and preserve the produce. . . .

On the first settling of a country in which there is an abundance of rich and fertile land, a very small proportion of which is required to be cultivated for the support of the actual population, or indeed can be cultivated with the capital which the population can command, there will be no rent; for no one would pay for the use of land when there was an abundant quantity not yet appropriated, and, therefore, at the disposal of whosoever might choose to cultivate it.

On the common principles of supply and demand, no rent could be paid for such land, for the reason stated why nothing is given for the use of air and water, or for any other of the gifts of nature which exist in boundless quantity. With a given quantity of materials, and

with the assistance of the pressure of the atmosphere, and the elasticity of steam, engines may perform work, and abridge human labour to a very great extent; but no charge is made for the use of these natural aids, because they are inexhaustible and at every man's disposal. In the same manner, the brewer, the distiller, the dyer, make incessant use of the air and water for the production of their commodities; but as the supply is boundless, they bear no price. If all land had the same properties, if it were unlimited in quantity, and uniform in quality, no charge could be made for its use, unless where it possessed peculiar advantages of situation. It is only, then, because land is not unlimited in quantity and uniform in quality, and because, in the progress of population, land of an inferior quality, or less advantageously situated, is called into cultivation, that rent is ever paid for the use of it. When, in the progress of society, land of the second degree of fertility is taken into cultivation, rent immediately commences on that of the first quality, and the amount of that rent will depend on the difference in the quality of these two portions of land.

When land of the third quality is taken into cultivation, rent immediately commences on the second, and it is regulated as before by the differences in their productive powers. At the same time, the rent of the first quality will rise, for that must always be above the rent of the second by the difference between the produce which they yield with a given quantity of capital and labour. With every step in the progress of population, which shall oblige a country to have recourse to land of a worse quality, to enable it to raise its supply of food, rent, on all the more fertile land, will rise.

Thus suppose land—No. 1, 2, 3—to yield, with an equal employment of capital and labour, a net produce of 100, 90, and 80 quarters of corn. In a new country, where there is an abundance of fertile land compared with the population, and where therefore it is only necessary to cultivate No. 1, the whole net produce will belong to the cultivator, and will be the profits of the stock which he advances. As soon as population had so far increased as to make it necessary to cultivate No. 2, from which ninety quarters only can be obtained after supporting the labourers, rent would commence on No. 1; for either there must be two rates of profit on agricultural capital, or ten quarters, or the value of ten quarters must be withdrawn from the produce of No. 1 for some other purpose. Whether the proprietor of the land, or any other person, cultivated No. 1, these ten quarters would equally constitute rent; for the cultivator of No. 2 would get the same result with his capital whether he cultivated No. 1, paying ten quarters for rent, or continued to cultivate No. 2, paying no rent. In the same manner it might be shown that when No. 3 is brought

into cultivation the rent of No. 2 must be ten quarters, or the value of ten quarters, whilst the rent of No. 1 would rise to twenty quarters; for the cultivator of No. 3 would have the same profits whether he paid twenty quarters for the rent of No. 1, ten quarters for the rent of No. 2, or cultivated No. 3 free of rent.

It often, and, indeed, commonly happens, that before No. 2, 3, 4, or 5, or the inferior lands are cultivated, capital can be employed more productively on those lands which are already in cultivation. It may perhaps be found that by doubling the original capital employed on No. 1, though the produce will not be doubled, will not be increased by 100 quarters, it may be increased by eighty-five quarters, and that this quantity exceeds what could be obtained by employing the same capital on land No. 3.

In such case, capital will be preferably employed on the old land, and will equally create a rent; for rent is always the difference between the produce obtained by the employment of two equal quantities of capital and labour. If, with a capital of £1000, a tenant obtain 100 quarters of wheat from his land, and by the employment of a second capital of £1000 he obtain a further return of eighty-five, his landlord would have the power, at the expiration of his lease, of obliging him to pay fifteen quarters or an equivalent value for additional rent; for there cannot be two rates of profit. If he is satisfied with a diminution of fifteen quarters in the return for his second £1000, it is because no employment more profitable can be found for it. The common rate of profit would be in that proportion, and if the original tenant refused, some other person would be found willing to give all which exceeded that rate of profit to the owner of the land from which he derived it.

In this case, as well as in the other, the capital last employed pays no rent. For the greater productive powers of the first £1000, fifteen quarters, is paid for rent, for the employment of the second £1000 no rent whatever is paid. If a third £1000 be employed on the same land, with a return of seventy-five quarters, rent will then be paid for the second £1000, and will be equal to the difference between the produce of these two, or ten quarters; and at the same time the rent for the first £1000 will rise from fifteen to twenty-five quarters; while the last £1000 will pay no rent whatever.

If, then, good land existed in a quantity much more abundant than the production of food for an increasing population required, or if capital could be indefinitely employed without a diminished return on the old land, there could be no rise of rent; for rent invariably proceeds from the employment of an additional quantity of labour with a proportionally less return.

The most fertile and most favourably situated land will be first

cultivated, and the exchangeable value of its produce will be adjusted in the same manner as the exchangeable value of all other commodities, by the total quantity of labour necessary in various forms, from first to last, to produce it and bring it to market. When land of an inferior quality is taken into cultivation, the exchangeable value of raw produce will rise, because more labour is required to produce it.

The exchangeable value of all commodities, whether they be manufactured, or the produce of the mines, or the produce of land, is always regulated, not by the less quantity of labour that will suffice for their production under circumstances highly favourable, and exclusively enjoyed by those who have peculiar facilities of production; but by the greater quantity of labour necessarily bestowed on their production by those who have no such facilities; by those who continue to produce them under the most unfavourable circumstances; meaning—by the most unfavourable circumstances, the most unfavourable under which the quantity of produce required renders it necessary to carry on the production.

Thus, in a charitable institution, where the poor are set to work with the funds of benefactors, the general prices of the commodities, which are the produce of such work, will not be governed by the peculiar facilities afforded these workmen, but by the common, usual, and natural difficulties which every other manufacturer will have to encounter. The manufacturer enjoying none of these facilities might indeed be driven altogether from the market if the supply afforded by these favoured workmen were equal to all wants of the community; but if he continued the trade, it would be only on condition that he should derive from it the usual and general rate of profits on stock; and that could only happen when his commodity sold for a price proportioned to the quantity of labour bestowed on its production.

It is true that, on the best land, the same produce would still be obtained with the same labour as before, but its value would be enhanced in consequence of the diminished returns obtained by those who employed fresh labour and stock on the less fertile land. Notwithstanding, then, that the advantages of fertile over inferior lands are in no case lost, but only transferred from the cultivator, or consumer, to the landlord, yet, since more labour is required on the inferior lands, and since it is from such land only that we are enabled to furnish ourselves with the additional supply of raw produce, the comparative value of that produce will continue permanently above its former level, and make it exchange for more hats, cloth, shoes, etc., etc., in the production of which no such additional quantity of labour is required.

The reason, then, why raw produce rises in comparative value is because more labour is employed in the production of the last portion obtained, and not because a rent is paid to the landlord. The value of corn is regulated by the quantity of labour bestowed on its production on that quality of land, or with that portion of capital, which pays no rent. Corn is not high because a rent is paid, but a rent is paid because corn is high; and it has been justly observed that no reduction would take place in the price of corn although landlords should forego the whole of their rent. Such a measure would only enable some farmers to live like gentlemen, but would not diminish the quantity of labour necessary to raise raw produce on the least productive land in cultivation.

Nothing is more common than to hear of the advantages which the land possesses over every other source of useful produce, on account of the surplus which it yields in the form of rent. Yet when land is most abundant, when most productive, and most fertile, it yields no rent; and it is only when its powers decay, and less is yielded in return for labour, that a share of the original produce of the more fertile portions is set apart for rent. It is singular that this quality in the land, which should have been noticed as an imperfection compared with the natural agents by which manufacturers are assisted, should have been pointed out as constituting its peculiar pre-eminence. If air, water, the elasticity of steam, and the pressure of the atmosphere were of various qualities; if they could be appropriated, and each quality existed only in moderate abundance, they, as well as the land, would afford a rent, as the successive qualities were brought into use. With every worse quality employed, the value of the commodities in the manufacture of which they were used would rise, because equal quantities of labour would be less productive. Man would do more by the sweat of his brow and nature perform less; and the land would be no longer pre-eminent for its limited powers.

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THE "TRUE" REMEDY

HENRY GEORGE

WE HAVE TRACED the unequal distribution of wealth which is the curse and menace of modern civilization to the institution of private property in land. We have seen that so long as this institution exists no increase in productive power can permanently benefit the masses; but, on the contrary, must tend still further to depress their condition. We have examined all the remedies, short of the abolition of private property in land, which are currently relied on or proposed for the relief of poverty and the better distribution of wealth, and have found them all inefficacious or impracticable.

There is but one way to remove an evil—and that is to remove its cause. Poverty deepens as wealth increases, and wages are forced down while productive power grows, because land, which is the source of all wealth and the field of all labor, is monopolized. To extirpate poverty, to make wages what justice commands they should be, the full earnings of the laborer, we must therefore substitute for the individual ownership of land a common ownership. Nothing else will go to the cause of the evil—in nothing else is there the slightest hope.

This, then, is the remedy for the unjust and unequal distribution of wealth apparent in modern civilization, and for all the evils which flow from it:

We must make land common property.

We have reached this conclusion by an examination in which every step has been proved and secured. In the chain of reasoning no link is wanting and no link is weak. Deduction and induction have brought us to the same truth—that the unequal ownership of land necessitates the unequal distribution of wealth. And as in the nature of things unequal ownership of land is inseparable from the recogni-

tion of individual property in land, it necessarily follows that the only remedy for the unjust distribution of wealth is in making land common property.

But this is a truth which, in the present state of society, will arouse the most bitter antagonism, and must fight its way, inch by inch. It will be necessary, therefore to meet the objections of those who, even when driven to admit this truth, will declare that it cannot be practically applied.

In doing this we shall bring our previous reasoning to a new and crucial test. Just as we try addition by subtraction and multiplication by division, so may we, by testing the sufficiency of the remedy, prove the correctness of our conclusions as to the cause of the evil.

The laws of the universe are harmonious. And if the remedy to which we have been led is the true one, it must be consistent with justice; it must be practicable of application; it must accord with the tendencies of social development and must harmonize with other reforms.

All this I propose to show. I propose to meet all practical objections that can be raised, and to show that this simple measure is not only easy of application; but that it is a sufficient remedy for all the evils which, as modern progress goes on, arise from the greater and greater inequality in the distribution of wealth—that it will substitute equality for inequality, plenty for want, justice for injustice, social strength for social weakness, and will open the way to grander and nobler advances of civilization.

I thus propose to show that the laws of the universe do not deny the natural aspirations of the human heart; that the progress of society might be toward equality, not toward inequality; and that the economic harmonies prove the truth perceived by the Stoic Emperor—

"We are made for co-operation—like feet, like hands, like eyelids, like the rows of the upper and lower teeth."

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THE NATHAN REPORT

ROBERT R. NATHAN ASSOCIATES, INC.

[NOTE: In 1947, the Robert R. Nathan Associates, Inc., published "An Analysis Prepared for the Congress of Industrial Organizations" in support of "A National Wage Policy for 1947." Below are printed the main conclusions. These are followed by Professor Sumner H. Slichter's analysis of the report.]

1. Recent economic tendencies have brought uncertainty and instability, widespread fear of business losses, and the prospect of a sharp decline in employment sometime during 1947. . . .

2. Never in recent years has the national interest so clearly required a major increase in real wage rates. . . .

3. Public opinion has been lured into a false sense of security with respect to national wage trends by exaggeration of the extent and the significance of increases in straight-time hourly earnings. . . .

4. While there has been a sizeable increase in dollars and cents straight-time hourly earnings, the increase in cost to employers of an hour of work has been much more modest. The increase in labor cost per unit of product has been even smaller. . . .

5. The average weekly earnings of production workers in manufacturing have declined—even in dollars and cents—during the past two years. In general only workers in the lower-paying industries have had increases in their weekly earnings during this period. . . .

6. Taking into account the increase in living costs during the past two years, the decline in the real weekly earnings of almost all classes of workers has been very great. On the average, in all manufacturing, an increase of about 21 percent in weekly earnings—without any increase in prices—would have been required in October 1946 to bring real weekly earnings back to the January 1945 level. By the end of

1946, with the present trend of prices, an increase of about 23 percent will be required. . . .

7. The real hourly earnings of labor in all manufacturing in October 1946 required an increase of 8.0 percent to equal the real hourly earnings of January 1945. With present price and wage trends, the real increase required at the end of 1946 will be about 10 percent. . . .

8. There has been one outstanding development in the earnings of labor during the past two years. This development has been a very pronounced tendency for the lowest-paid groups of workers to receive the relatively larger wage increases. . . .

9. At full employment, the present price and wage structure of American industry yields a level of corporate profits before taxes as high as at the lushest period of war prosperity. It yields a level of corporate profits after taxes about 50 percent higher than the war peak and utterly without earlier precedent in our national experience. . . .

10. Total corporate income has risen much more rapidly since 1939—and especially since 1945—than income from wages and salaries. . . .

11. In spite of the increase in corporate taxation since the late 1930's, total corporate profits after taxes are now greatly higher in relation to sales than they were in the prewar period. . . .

12. Corporate profits are now especially high in relationship to net worth or to any other significant measure of the stake of ownership in business operations. . . .

13. Even manufacturing corporations, whose profit position has not improved nearly so much as that of all other corporations, can afford to grant their production workers an increase of 21 percent in total earnings at the present time without reducing the corporate rate of return on net worth to a level below the 1936–39 average of 6.9 percent. . . .

14. The salient facts of the wage-price-profit situation in American business today indicate that the national interest requires a major general increase in wage rates. It is most important that this general wage advance be achieved without crippling work stoppages. . . .

15. The facts all lead to the conclusion that not only from the worker's point of view but also for the benefit of the whole economy a further substantial wage increase without a general price increase is possible, justifiable and essential. . . .

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MR. NATHAN'S REPORT ON WAGE POLICY

SUMNER H. SLICHTER

I

MR. NATHAN'S REPORT for the Congress of Industrial Organizations, "A National Wage Policy for 1947," is one of the most useful documents which has been issued in many a month. It is useful, not for the conclusions which it reaches, because these are in large part wrong, but for the issues which it raises. Among these issues are:

> When are prices too high? What yardstick does one use in answering this question?
> When are profits too large?
> When are wages too low?
> What is the role of profits in a free economy?
> How do general changes in the wage level affect the price level?
> Are higher money wages a cure for a price level which is too high?

These are the kinds of issues which the members of a free society need to face and to understand in order to make the economy operate with stability. If the people of America can be induced to explore thoroughly the issues raised by Mr. Nathan, they will learn more economics in the next three months than they have learned in all of their lives.

Mr. Nathan has also performed an important service to the community by proposing that collective bargaining be conducted within the framework of a national wage policy. The particular wage policy proposed by Mr. Nathan may be bad. It is of first importance, however, that both trade unions and employers consider the effect of proposed wage changes upon the community as a whole as well as upon the immediate parties to the negotiation. That is what

Mr. Nathan proposes. The community should put the full force of public opinion behind this idea.

Mr. Nathan has also performed a useful service by compelling business to face the question of whether prices are not too high. I do not think that Mr. Nathan uses the right yardsticks to determine whether or not prices are too high, and I do not agree with the remedy which he proposes. Nevertheless, I agree with him that a large proportion of prices are too high. It is important that this matter be brought squarely to the attention of the community.

II

What is Mr. Nathan's diagnosis of the business situation today and what does he propose be done about it?

"Prosperity far beyond anything ever achieved previously in peacetime seems to be prevalent today," says Mr. Nathan, and "yet there is a growing sense of uncertainty and even of insecurity." The basic trouble, according to Mr. Nathan, is the rapid rise in prices during recent months. Three-fourths of the gainfully employed people in the United States are wage and salary earners. The great bulk of these have suffered a major decline in the real value of their earnings during the past two years and an especially rapid decline in the last few months. Meanwhile the incomes of farm operators (after all expenses) have risen substantially, and Mr. Nathan expects corporate profits in 1946 to be about 50 per cent above 1944.

Mr. Nathan says that the recent rapid rise in prices cannot be explained by increases in wages. He points out that between January 1945 and October 1946 the cost of an hour's labor in manufacturing has risen 8.6 cents, or 8.2 per cent, but the wholesale prices of manufactured goods have risen by 27.9 per cent. Most of the wage increases, however, have occurred since October 1945. Between that date and October 1946 hourly earnings in manufacturing have increased 14.9 per cent and wholesale prices of non-agricultural products 12.6 per cent.

Mr. Nathan concludes that "unless there is an immediate increase in wages or a sharp drop in prices, we are flirting with collapse." There is no evidence to indicate that business will cut prices prior to a depression. "Hence," says Mr. Nathan, "raising wages without increasing prices appears to offer the only currently possible means of bringing about the kind of relationship which will avoid a serious decline in business activity."

Mr. Nathan does not suggest how large the wage increase should be. He suggests that it be "sizeable". He hazards the guess that corporate enterprise as a whole could raise the wages of production

workers 25 per cent without raising prices and without reducing the return after taxes on net worth to a rate below that of 1936–39. In manufacturing alone he believes that wages of production workers could be raised 21 per cent without reducing the return after taxes on net worth to a rate below that of 1936–39.

III

Has Mr. Nathan made a sound diagnosis and has he prescribed sound policies? Let us analyze first his diagnosis and then his remedy.

Mr. Nathan's conclusion that prices are too high for stability impresses me as correct, but the evidence upon which he bases his conclusion does not prove his point. Mr. Nathan believes that prices are too high (1) because they have risen in recent months faster than payrolls and (2) because profits have recently risen faster than other forms of income.

The relationship between payrolls and prices will always bear watching, but the fact that prices have risen faster (or slower) than payrolls proves nothing about the stability of prices. Payrolls are not the only form of income; they represent slightly more than three-fifths of all incomes. Hence the fact that prices have risen faster than payrolls does not mean that they have reached a level where they will not remain.

Prices during the last year have risen faster than *all* incomes of individuals after taxes. This looks dangerous and may well be dangerous, but even this does not prove that prices are too high for stability. Individuals are not the only buyers of goods. Corporations and governments are both substantial buyers. Hence the incomes of individuals after taxes are not the measure of the market for goods —they are the measure of only part of the market. Both the retained profits of corporations and the expenditures of government are the basis for demand for goods.

This brings us to Mr. Nathan's second reason for regarding prices as too high—namely that profits for the third quarter of 1946 were substantially above the annual rate of 1945 or 1944. Profits may or may not be higher than most people regard as fair, but neither result is proof that prices are or are not too high to be stable. The implicit assumption in Mr. Nathan's argument is that profits are different from all other forms of income in that they are spent more slowly than other kinds of income. Hence he regards a rise in profits as presaging collapse. This is a widely-held belief, but it is for the most part nonsense. The rate at which profits, either when distributed to individuals as dividends or when retained in the business, are spent

is sensitive to the outlook for business and may well fluctuate more than the rate at which other incomes are spent. At the present time, however, when business concerns are short of inventories and equipment, there is much indirect evidence that profits are being spent rapidly, especially the profits retained by business concerns. The evidence is found (1) in the fact that the cash and bank deposits and government securities held by business concerns dropped by $2.8 billion between December 1945 and June 1946; (2) in the rapid increase in commercial loans indicating that business concerns have not been able to finance their expenditures out of current income; and (3) in the large volume of new issues of preferred stock and other securities to provide business concerns with working capital and funds for expansion, again indicating that current income has been insufficient to meet expenditures.

The essence of the matter is that Mr. Nathan has attempted to prove that prices are too high by a method which is incapable of proving his point—by comparing prices with incomes. Since the incomes created by the sale of goods equal the expenditures for goods (they are merely two aspects of the same money-transfer), merely comparing the rise of prices with the rise of this or that form of income or even with incomes in general will never prove prices are too high—the best it will do will be to suggest certain danger spots. And yet I believe that Mr. Nathan is right in concluding that many prices at least are too high. For this conclusion there are several reasons:

(1) The restoration of agriculture in Europe and elsewhere will make possible substantial increases in the supplies of farm products. Farm prices have risen faster than other prices. They are about 150 per cent above 1940 and 70 per cent above 1926. Goods other than farm products and foods are about 40 per cent above 1940 and about 20 per cent above 1926. They are substantially above the long-run point of equilibrium between supply and demand.

(2) An appreciable part of present output of manufactured goods has been going into inventories and to fill "pipe-lines". During this period, income payments of individuals are higher relative to the output of end product than is the case after the period of "pipe-line" filling is over. Perhaps the rise in the output of industrial equipment and housing which is going on will offset the drop in "pipe-line" filling and will keep the relationship between the incomes of individuals and the output of end product as a whole unaltered. Nevertheless, the relationship between supply of many products which have been scarce and the demand for them will be altered during the next few months.

(3) Many prices have been bid up by an expansion of commercial credit which has exceeded the increase in physical output and by the expansion of consumer credit. When enterprises and individuals begin paying off old debts faster than they incur new ones, the demand for goods will drop.

(4) Finally, many prices, especially prices of foods and apparel, have been bid up higher than they can be expected to remain because people could not spend the usual fraction of their incomes upon durable goods or because they had acute needs. Unless there is a large and rapid rise in incomes, these prices will fall. The prospect of a fall is viewed differently by different business men. Some business men regard it with apprehension, fearing that the fall in the out-of-line prices will undermine confidence in all prices. Other business men view the prospective fall optimistically, believing that, after these corrections have occurred, business will have a better foundation upon which to build long-range plans. At any rate two things are clear: (1) a price structure which contains many out-of-line prices limits demand by discouraging the execution of long-range plans by some enterprises and (2) the correction, after it has occurred, helps sustain employment.

IV

What about Mr. Nathan's remedy for a price level which he regards as too high to be stable? He proposes "sizeable" wage increases without increasing prices. "Such a policy," he says, "would step up buying power and bring back into the market for many categories of goods these millions of working families who have been removed from the market because of rising prices." Let us assume that "sizeable" wage increases were made, as Mr. Nathan suggests, without a gain in labor efficiency and without an increase in prices. What would happen?

Mr. Nathan's proposal would have little or no effect upon the reasons for regarding the present price level as unstable which I have outlined above. Raising wages without a rise in efficiency or in prices would undoubtedly limit the expansion of commercial credit, and this might be a contribution to stability. It would also contribute to stability by limiting the expansion of consumer credit because, as I shall point out presently, higher wages without a rise in prices would produce some unemployment. This, however, would be an expensive way to discourage an increase in consumer credit.

Higher wages without a rise in efficiency or prices would give little support to farm prices or to the prices of various goods which had been pushed too high during the recent period of shortage unless they raised the purchasing power of consumer incomes. I shall point

out presently, however, that higher wages without higher prices would diminish employment. Hence, it is uncertain whether consumer incomes would be reduced instead of raised. At the best only a small rise in consumer incomes could be expected. This would be of scant help in cushioning the drop in the prices of farm products, or the prices which were pushed too high during recent shortages.

Mr. Nathan takes for granted that what is needed is an increase in the demand for consumer goods. That is why he proposes to increase payrolls at the expense of profits. As far as the prevention of recession is concerned, what is needed is the maintenance of the demand for goods regardless of whether the goods are consumer goods, or capital goods. The maintenance of demand for consumer goods, of course, helps but so also does the maintenance of the demand for capital goods. Steel, machinery, railroad cars, boilers, turbines, and other capital goods are made by men no less than are shoes, clothing, suits, bread, hosiery or furniture. For example, a drop in the demand for capital goods would throw out of work thousands of men in the steel industry and the industrial equipment industries, and thus tend to reduce the demand for consumer goods. Certainly Mr. Nathan is wrong if he assumes that the demand for consumer goods has some peculiar stabilizing effect which the demand for other goods lacks.

Mr. Nathan also takes it for granted that a rise in wages with prices remaining unchanged will increase consumer purchasing power. This, however, is far from certain. A rise in wages without a rise in efficiency or prices would not necessarily mean larger payrolls. Without question it would produce a drop in employment. Many firms are marginal—they are making just enough to keep going. An increase in wages without a rise in prices would put them out of business. Many firms which are highly prosperous are making certain items for which the price barely covers present costs or are selling part of their output in some markets where their costs at present wages are barely covered. Hence a rise in wages without an increase in efficiency or a rise in prices would cause a shrinkage in employment by stopping production in marginal firms and stopping part of the production in prosperous firms. The drop in employment from a "sizeable" rise in wages without a rise in prices might easily be sufficient to produce smaller payrolls instead of larger ones.

Even if an increase in wages produced a rise in payrolls, the gain in the demand for consumer goods would be less than the rise in payrolls. Mr. Nathan proposes that payrolls be increased at the expense of profits but a large part of profits are spent for consumer goods. Hence, a rise of payrolls at the expense of profits would reduce the demand for consumer goods purchased out of profits.

All of this analysis points to the conclusion that the net effect of the rise in wages without an increase in efficiency or prices upon consumer incomes is uncertain. The rise in the price of labor would tend to increase consumer incomes; the drop in employment and the encroachment upon profits would tend to diminish consumer incomes. The safest conclusion seems to be: (1) that a "sizeable" wage increase, such as Mr. Nathan proposes, would without question produce a large increase in unemployment and probably a drop in consumer incomes; and (2) that even if the wage increase produced a rise in consumer incomes, this would be small and would have virtually no effect in removing the conditions which make many business men fear a recession.

Let us look more closely into the amount of unemployment which would be created by a "sizeable" increase in wages without a change in efficiency or in prices. Curiously enough Mr. Nathan does not consider this vital question. Mr. Nathan might argue that under present conditions employment would be less unfavorably affected than usual by a rise in wages without a rise in efficiency or prices, and I would agree with him. Recent shortages of materials, equipment, and labor have prevented many firms from increasing production up to limits warranted by present cost-price relationships. Mr. Nathan seems to regard a "sizeable" wage increase as 25 per cent. At least he asserts that the corporate part of business (which turns out about two-thirds of the part of the national product of all of private industry) could raise the wages of production workers 25 per cent without reducing the return on net worth after taxes below that of 1936–39. He does not explain why he regards the rate of profit in 1936 to 1939 as the "right" rate.

How much would reducing the rate of profits to the level of 1936–1939 reduce employment? In each year of the period 1936–1939 more than half of all corporations operated at a loss. The average rate of profit per dollar of sales during this period for all corporations was only 3.3 cents. Sales of corporations at the present time are double the average rate of sales between 1936–1939. If return on net worth were no greater than during the period 1936–1939, return per dollar on the *present* volume of sales would be less than 2 cents. At this small margin for all corporations, the proportion of business done at a loss would be far greater than in 1936–1939. Furthermore, on such a small margin, concerns would be deterred from launching new products and new lines or from invading new markets unless the return seemed quite assured. Plainly at the rate of profit which Mr. Nathan proposes the present volume of goods would not be produced. Thousands of firms would shut down and thousands of

others would curtail production. This is a queer way to achieve "stability".

No one knows how much employment would be reduced by raising wages relative to prices until corporate profits had been reduced to the rate of 1936 to 1939. A rough indication is given by the fact that the cost-price relationships which yielded the small profits of the period 1936 to 1939 permitted the employment of about 9 million fewer employees in private industry than are on the payrolls today.

V

One of the most serious defects of Mr. Nathan's report is that it deals only with general averages. He asserts that prices *in general* are too high, that wages *in general* are too low, that profits *in general* are too high. General averages are not a safe basis upon which to make policy decisions. General averages conceal the fact that there are many prices which do not cover costs, that there are many enterprises operating in the red, and that there are many wage earners who did not receive wage increases during the last year. A recent survey of 6,600 enterprises by the U. S. Bureau of Labor Statistics shows that between V-J Day and May 1946, 21.3 per cent of the workers in manufacturing and 59.2 per cent in non-manufacturing industries received no general wage increases. The unions which are making the biggest demands for a second round of wage increases are the very ones which gained the most in the first round.

Any national wage policy must take account of the differences in recent movements of prices, wages, and profits in different industries. Prices have risen substantially for some goods for which there was an immediate and urgent demand and which could not be increased promptly in supply. Food is the outstanding example. Retail food prices in October were 89 per cent above 1940 in comparison with a rise of 49.3 per cent in the consumer goods price index. There are other goods which have risen because of temporary bulges in demand or temporary shortages in supply. A uniform wage increase would, of course, force wages up in industries where prices are low relative to costs. If Mr. Nathan's idea of no price increases were followed, employment and production would be drastically curtailed in these industries. The curtailment of production would create bottlenecks for other industries and throw additional thousands of men out of work. In other words, the country would promptly find itself confronted again with the multitude of bottleneck problems which plagued it and distorted and limited production during the days of the O.P.A.

If wages were raised only in the industries where profits are high

because of temporary bulges in demand which exceed the capacity of the industry or because of temporary shortages in supply, Mr. Nathan's policy would help to perpetuate present maladjustments in the price structure. The prices which ought to fall and which will fall as the backlog of demand is met, as bottlenecks are eliminated, and as productive capacity is increased would be prevented from falling by the rise in labor costs. Does it make sense thus to freeze the maladjustments in the price structure which have grown up during this year of shifting from war production to civilian production?

If raising wages is not the remedy for the fact that some prices are too high in relation to costs, what is the remedy? It is simple. As the urgent demand which accumulated during the war is met, and as bottlenecks which have been holding down production are removed, the out-of-line prices drop. This process is already beginning and will be more marked after Christmas. It does not mean that a recession is beginning. On the contrary, it means that the wholesome process of readjustment is beginning. It is a process which should be encouraged. Mr. Nathan's policy of preventing a drop in prices by raising labor costs would prevent it from occurring except in those industries, such as agriculture, where little hired labor is used in producing goods which are in short supply.

One of the most unsatisfactory parts of Mr. Nathan's report is its failure to understand the role of profits in the modern economy. Mr. Nathan does not directly recommend that profits be reduced to the level of 1936–39, but his suggestions imply this. He does not even allow the profit receiver a rise to allow for the 50 per cent advance in the cost of living since that period! Surely the profit receiver, no less than the wage earner, is entitled to a rise to offset the rise in the cost of living. What is a good rule in one case is a good rule in another.

As a matter of fact, profits are the reward for two peculiarly useful activities. They are the return which business owners receive on equity capital and they are the yardstick by which managers demonstrate their efficiency to their employers by developing new methods and new products. Hence, the opportunity to make a profit is an incentive for investors to put more equity capital into industry and for managements to make more innovations. The striving of the owner operators and the managers of over 10 million business enterprises, agricultural and non-agricultural, to make more profit is what makes the American economy the most progressive and dynamic in the world. There would be no more sense in limiting the rate of profits to the rate earned in the period 1936 to 1939 than there would be in limiting the hourly earnings of workers to the amount earned in that period. Competition may gradually force down the return on capital to lower levels

than prevailed in the nineteenth century, as, in fact, competition has been doing. If profits are to be an effective incentive, however, arbitrary limits on them must be absent.

The function of profits in inducing the use of more and better capital in industry and in inducing management to improve methods and products is illustrated by the period 1880 to 1940. During this time capital per worker increased about three-fold, output per man-hour about four-fold, wages per hour about four-fold, and prices at the end of the period were at about the same level as at the beginning.

Mr. Nathan's repeated assertions that "profits are too large" raises the question of what yardstick one should use in judging what volume of profits is right. In some industries, as I have pointed out, profits are "too large" because of temporary bulges in demand or impediments to production which have raised profits above the levels needed to attract into those industries the amount of capital which is justified by the normal demand for the products of the industries. For industry as a whole, however, what determines whether or not profits are "too large"? Obviously this depends upon the rate at which the community wishes the plant and equipment of industry to be expanded. The higher the rate of profit, the greater the proportion of the country's productive capacity which will be devoted to increasing the plant and equipment of industry. The lower the rate of profit, the smaller the part of the country's productive capacity which will be devoted to making plant and equipment. It is significant that during the period 1936 to 1939, which Mr. Nathan uses as a yardstick for profits, there was no net increase in the capital of industry.

Perhaps the country wishes the expansion and improvement of industry to be checked. Before reaching this decision, however, people should bear in mind that during most of the time since 1929 the creation of capital for civilian industry has gone on at an abnormally low rate. During much of this time, the capital of the country's industry has been wearing out faster than it has been replaced. Today the country has far too little capital for a workforce of 60 million, and much of the capital in use is obsolete by up-to-date technological standards. Mr. Nathan proposes substantially to discourage the most important process by which the country can raise its standard of living.

Let me conclude these comments with a warning to business men. Although the expansion of American industry during the last century has been rapid, it has been uneven and has been interrupted by sharp recessions. A major reason for these interruptions has been the jerky expansion of bank loans. The rapid increase in bank loans during booms has given a temporary stimulus to demand, but a stimulus which lasted only so long as new debts were incurred as fast as old

ones were paid. The present outlook for business is not, as Mr. Nathan suggests, a depression. There are many price adjustments ahead and some of them will introduce uncertainties into the business situation and will cause some managers to be cautious about executing business plans. The quicker these price adjustments occur, the better. The underlying business outlook, however, is for a business expansion of unprecedented magnitude. Never have the backlogs of demand for durable consumer goods, housing, and industrial equipment been so huge. This creates a very real danger—namely, that the competition of consumers and business enterprisers for a limited supply of goods will lead to a substantial expansion in borrowing from banks. Unless the prospective boom is managed very differently from previous booms, it will end in a few years in collapse. If the economy is to achieve stability, business men must insist that this time controls on the expansion of bank credit are far more drastic and are imposed earlier than in any previous boom.

Business men would also do well to take to heart Mr. Nathan's charge that "there is no evidence to date to indicate that business will cut prices prior to a depression in which unemployment, declining incomes, and shrinking demand will make price declines unavoidable." Experience shows Mr. Nathan's charge to be unfounded, but business can always do with more price cutters, more enterprises which are willing to seek expansion by undercutting prices, more concerns which are willing to fight for a larger share of the business. This is the way to get expansion and to foster rivalry in improving products and in cutting costs. Finally, this is a time when price cutting is likely to prove far more profitable than usual. Consumers are holding well over three times as much currency and demand deposits as in prewar. They are drawing on their cash and banking accounts at about half the prewar rate. There is an enormous demand to be captured by enterprises which can offer goods at attractive prices.

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THE PROPENSITY TO CONSUME

JOHN MAYNARD KEYNES

GRANTED, THEN, THAT THE PROPENSITY TO CONSUME is a fairly stable function so that, as a rule, the amount of aggregate consumption mainly depends on the amount of aggregate income (both measured in terms of wage-units), changes in the propensity itself being treated as a secondary influence, what is the normal shape of this function?

The fundamental psychological law, upon which we are entitled to depend with great confidence both *a priori* from our knowledge of human nature and from the detailed facts of experience, is that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income. . . .

This is especially the case where we have short periods in view, as in the case of the so-called cyclical fluctuations of employment during which habits, as distinct from more permanent psychological propensities, are not given time enough to adapt themselves to changed objective circumstances. For a man's habitual standard of life usually has the first claim on his income, and he is apt to save the difference which discovers itself between his actual income and the expense of his habitual standard; or, if he does adjust his expenditure to changes in his income, he will over short periods do so imperfectly. Thus a rising income will often be accompanied by increased saving, and a falling income by decreased saving, on a greater scale at first than subsequently.

But, apart from short-period *changes* in the level of income, it is also obvious that a higher absolute level of income will tend, as a rule, to widen the gap between income and consumption. For the satisfaction of the immediate primary needs of a man and his family

is usually a stronger motive than the motives towards accumulation, which only acquire effective sway when a margin of comfort has been attained. These reasons will lead, as a rule, to a greater *proportion* of income being saved as real income increases. But whether or not a greater proportion is saved, we take it as a fundamental psychological rule of any modern community that, when its real income is increased, it will not increase its consumption by an equal *absolute* amount, so that a greater absolute amount must be saved, unless a large and unusual change is occurring at the same time in other factors. As we shall show subsequently, the stability of the economic system essentially depends on this rule prevailing in practice. This means that, if employment and hence aggregate income increase, *not all* the additional employment will be required to satisfy the needs of additional consumption.

On the other hand, a decline in income due to a decline in the level of employment, if it goes far, may even cause consumption to exceed income not only by some individuals and institutions using up the financial reserves which they have accumulated in better times, but also by the Government, which will be liable, willingly or unwillingly, to run into a budgetary deficit or will provide unemployment relief, for example, out of borrowed money. Thus, when employment falls to a low level, aggregate consumption will decline by a smaller amount than that by which real income has declined, by reason both of the habitual behaviour of individuals and also of the probable policy of governments; which is the explanation why a new position of equilibrium can usually be reached within a modest range of fluctuation. Otherwise a fall in employment and income, once started, might proceed to extreme lengths.

This simple principle leads, it will be seen, to the same conclusion as before, namely, that employment can only increase *pari passu* with an increase in investment; unless, indeed, there is a change in the propensity to consume. For since consumers will spend less than the increase in aggregate supply price when employment is increased, the increased employment will prove unprofitable unless there is an increase in investment to fill the gap.

* * * *

Consumption—to repeat the obvious—is the sole end and object of all economic activity. Opportunities for employment are necessarily limited by the extent of aggregate demand. Aggregate demand can be derived only from present consumption or from present provision for future consumption. The consumption for which we can

profitably provide in advance cannot be pushed indefinitely into the future. We cannot, as a community, provide for future consumption by financial expedients but only by current physical output. In so far as our social and business organisation separates financial provision for the future so that efforts to secure the former do not necessarily carry the latter with them, financial prudence will be liable to diminish aggregate demand and thus impair well-being, as there are many examples to testify. The greater, moreover, the consumption for which we have provided in advance, the more difficult it is to find something further to provide for in advance, and the greater our dependence on present consumption as a source of demand. Yet the larger our incomes, the greater, unfortunately, is the margin between our incomes and our consumption. So, failing some novel expedient, there is, as we shall see, no answer to the riddle, except that there must be sufficient unemployment to keep us so poor that our consumption falls short of our income by no more than the equivalent of the physical provision for future consumption which it pays to produce to-day.

Or look at the matter thus. Consumption is satisfied partly by objects produced currently and partly by objects produced previously, *i.e.,* by disinvestment. To the extent that consumption is satisfied by the latter, there is a contraction of current demand, since to that extent a part of current expenditure fails to find its way back as a part of net income. Contrariwise, whenever an object is produced within the period with a view to satisfying consumption subsequently, an expansion of current demand is set up. Now all capital-investment is destined to result, sooner or later, in capital-disinvestment. Thus the problem of providing that new capital-investment shall always outrun capital-disinvestment sufficiently to fill the gap between net income and consumption presents a problem which is increasingly difficult as capital increases. New capital-investment can only take place in excess of current capital-disinvestment if *future* expenditure on consumption is expected to increase. Each time we secure to-day's equilibrium by increased investment we are aggravating the difficulty of securing equilibrium to-morrow. A diminished propensity to consume to-day can only be accommodated to the public advantage if an increased propensity to consume is expected to exist some day. We are reminded of "The Fable of the Bees"—the gay of to-morrow are absolutely indispensable to provide a *raison d'être* for the grave of to-day.

It is a curious thing, worthy of mention, that the popular mind seems only to be aware of this ultimate perplexity where *public* investment is concerned, as in the case of road-building and house-build-

ing and the like. It is commonly urged as an objection to schemes for raising employment by investment under the auspices of public authority that it is laying up trouble for the future. "What will you do," it is asked, "when you have built all the houses and roads and town halls and electric grids and water supplies and so forth which the stationary population of the future can be expected to require?" But it is not so easily understood that the same difficulty applies to private investment and to industrial expansion; particularly to the latter, since it is much easier to see an early satiation of the demand for new factories and plant which absorb individually but little money, than the demand for dwelling-houses.

The obstacle to a clear understanding is, in these examples, much the same as in many academic discussions of capital, namely, an inadequate appreciation of the fact that capital is not a self-subsistent entity apart from consumption. On the contrary, every weakening in the propensity to consume regarded as a permanent habit must weaken the demand for capital as well as the demand for consumption.

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INCOME DISTRIBUTION, SAVING, AND ECONOMIC PROGRESS

H. G. MOULTON

IN THE EARLY 1930's the Brookings Institution undertook a pioneering study of the operation of the economic system with special reference to the possible bearing of the distribution of income upon economic progress. Did the way in which current national income was divided among the various groups in society serve to retard capital development and improvements in living standards? Was there any validity

in the conception of *under*consumption or *over*saving? Concretely, was there any evidence supporting the view that productive capacity had outrun consuming capacity? Were the assumptions underlying the traditional approach valid? Since the investigation was not directly concerned with the causes of depression, it was confined to the period prior to the economic collapse of 1929.

(Stated in the briefest possible terms, the conclusions reached were as follows:

The United States even in good times usually had a substantial amount of idle productive capacity.

While the *wants* or needs of the population on the other hand were far from satisfied, the effective *demand* as manifested in consumer markets for the products of industry was not sufficient to call forth full use of our productive capacity.

Prior to 1930 national income was being increasingly concentrated in the higher brackets where a larger percentage is set aside as savings.

Two basic propositions or generalizations were derived from the evidence afforded by family budget studies relating to spending and saving:

> *The higher the general level of income of the population as a whole, the greater will tend to be the proportion of the aggregate that is saved.*
>
> *The greater the concentration of the national income in the hands of a small percentage of the population, the greater will be the proportion of the aggregate national income that is saved.*

The growth of productive capital is adjusted not to the volume of money savings available for investment but to the growth of consumptive demand. The rapid growth of money savings as compared with consumer expenditures in the twenties retarded rather than accelerated the growth of productive capital.

The remedy suggested was to broaden the distribution of income and thereby establish a more effective ratio between consumptive expenditure and saving. The most effective means of modifying the distribution of income was held to be to alter the stream at its source—that is, within the business enterprises wherein the income is generated.

Price reduction in line with increased productivity was considered to be the most effective means of improving the distribution of income. This method places emphasis upon an ever-broadening distribution of the new income generated by technological progress. The

dynamic requirement is to increase income among the masses sufficiently to provide the essential consumption outlets.)

The most influential study of the forces responsible for protracted unemployment is that published in 1936 by the British economist John Maynard Keynes. The problem, as he saw it, was to explain why the economic system was continuing to function at a subnormal level—in a sort of equilibrium, but with persistent unemployment. While Keynes' analysis reflected his preoccupation with the causes of the protracted depression during which he wrote, it extended, in its implications, to the fundamental factors upon which the perpetuity of the private enterprise system depends.

The "essence of the theory" is set forth by Keynes himself in the following language:

> When employment increases, aggregate real income is increased. The psychology of the community is such that when aggregate real income is increased aggregate consumption is increased, but not by so much as income. Hence employers would make a loss if the whole of the increased employment were to be devoted to satisfying the increased demand for immediate consumption. Thus, to justify any given amount of employment there must be an amount of current investment sufficient to absorb the excess of total output over what the community chooses to consume when employment is at the given level. For unless there is this amount of investment the receipts of the entrepreneurs will be less than is required to induce them to offer the given amount of employment. It follows, therefore, that, given what we shall call the community's propensity to consume, the equilibrium level of employment, *i.e.* the level at which there is no inducement to employers as a whole either to expand or to contract employment, will depend on the amount of current investment. The amount of current investment will depend, in turn, on what we shall call the inducement to invest; and the inducement to invest will be found to depend on the relation between the schedule of the marginal efficiency of capital and the complex of rates of interest on loans of various maturities and risks.
>
> . . . The effective demand associated with full employment is a special case, only realised when the propensity to consume and the inducement to invest stand in a particular relationship to one another. . . . This optimum relationship . . . can only exist when, by accident or design, current investment provides an amount of demand just equal to the excess of the aggregate supply price of the output resulting from full employment over what the community will choose to spend on consumption when it is fully employed. . . .

Our interpretation of the meaning of this statement may be summarized as follows:

> 1. When national income is expanding, consumptive expenditures do not increase proportionally; hence the percentage directed to savings channels increases.
> 2. It would not pay businessmen to increase the output of consumption goods proportionally to the increase in total income—because consumers would not buy that amount of additional commodities.
> 3. There will be less than full employment except when new capital construction happens (occasionally) to be just equal to the volume of savings funds.
> 4. The amount of new capital construction depends on the *inducement* to business managers to invest in new plant and equipment.
> 5. The inducement to invest exists only when money market rates of interest are lower than the marginal productive efficiency of capital equipment.

There are some points of seeming resemblance between Keynes' theory and the conclusions reached in the [Brookings Institution] studies. . . . First, Keynes notes a tendency for consumption to increase less rapidly than savings as national income expands. Second, he implies that restriction of consumption may retard capital expansion rather than stimulate it; indeed, at one place he characterizes as an "absurd fallacy" the idea that "current investment is promoted by individual saving to the same extent that present consumption is diminished." Third, he points out that money savings are not always fully used in expanding plant and equipment; in fact, this is the phenomenon with which his analysis is primarily concerned.

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KEYNES'S ATTRIBUTES THE RELATIVE INCREASE IN MONEY SAVINGS TO WEAK CONSUMPTIVE DESIRES

He contends that the rise in the proportion saved when national income is expanding is primarily due to psychological factors governing the propensity of the *average* man to consume. "The fundamental psychological law . . . is that men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income." These psychological characteristics of human nature—together with social practices and institutions which also affect the volume of consumption—"though not

unalterable, are unlikely to undergo a material change over a short period of time except in abnormal or revolutionary circumstances."

This analysis is in line with the traditional assumption that the amount of savings is primarily a reflection of the thrift habits of the average individual—of the masses of the people. It would appear that aggregate national savings increase only as the *ordinary* individual becomes inherently more thrifty. This approach overlooks the great importance of the savings of *extraordinary* individuals—those with very large incomes. . . . Without any change in individual propensities to be thrifty, the proportion of the national income saved may rise sharply because of an increasing concentration of income in the hands of the wealthy. Keynes made only casual mention of the concentration of income as a factor in the expansion of savings; it finds little place in his basic analysis.

The first assumption, that consumptive desires are weak, is belied by the facts. Family budget studies . . . show conclusively that consumption expands not slowly but rapidly as income increases. It is true that the *proportion* spent declines and the *proportion* saved increases as income rises. But the explanation of the phenomenon is found not in a low *propensity* to consume but in a strong *disposition* to provide for the future as and when rising incomes afford a margin above the primary necessities of life. Keynes' failure to ascertain from factual studies the true nature of the phenomenon led him, as we shall presently show, to wholly unwarranted conclusions.

THE INTERPRETATION OF THE LAG IN CAPITAL FORMATION IS LACKING IN CONSISTENCY

Although he suggested at places that consumptive demand is of controlling importance—that it would not pay business enterprisers in quest of profits to construct new capital when consumption is declining, or increasing but slowly—Keynes forgot this completely when analyzing what he calls the inducement to invest. In accounting for the failure of money savings to be fully used in constructing new capital, he concentrated on the spread between the market rate of interest and the productivity of additional capital. He assumed that money savings available for investment are typically taken off the market through the medium of bond issues or other interest-bearing obligations and that the corporate manager gauges the outlook for profit by comparing the rate of interest he will have to pay in the money market with the prospective yield from the new capital equipment.

However he did not consistently adhere to the view that new capi-

tal construction depends upon the decisions of business enterprisers. At times he shifted from the calculations of business borrowers to those of individual savers and explained why the latter do not always devote their money savings to new capital construction. He attributed this to what he calls "liquidity preference"—meaning that under certain conditions it seems wiser for individuals to hold current savings in cash or equivalent rather than to venture them in new plant and equipment.

It should be apparent that if the demand for consumer goods increases but slowly because of a weak propensity to consume, the outlook for sales of additional consumer goods produced by additional capital would be *bad*—irrespective of the rate of interest. The spread might be ever so favorable, and yet it would not pay to produce goods which by hypothesis could not be sold. Similarly, if consumer demand is inadequate, it would be immaterial whether individual savers were interested in holding their savings in liquid form or disposed to lend them freely. The dark outlook for profitable investment would leave the entrepreneur with no incentive to borrow, or for that matter to use his own savings directly in building new plant and equipment.

Keynes' analysis of the capital formation process is thus essentially different from ours. He makes no clear differentiation among the three distinct stages in the money-saving, market-investment, capital-formation process. In his thinking there are at the most two stages —money saving and "investment"—by which he means actual capital formation. Thus he failed to appreciate the fact that expenditures for consumption plus new capital formation may be less than total national disbursements and to understand the effects of "excess" savings upon the prices of already existing capital instruments. In fact, it is the operation of the *market-investment* process which determines in general the market rate of interest; when the supply of money savings is large relative to the volume of new security flotations, the use of money savings in buying already outstanding securities serves to bid up their prices, with a resulting decrease in yields.

THE ANALYSIS OF CONTROLLING FACTORS IN CAPITAL EXPANSION HAS TWO VITAL DEFECTS

(1) Keynes' thesis that the inducement to invest is found in the spread between interest rates and the productivity of added units of capital implies that the margin of profit is primarily, if not exclusively, measured by the difference between the cost of borrowed money and the output of the new unit of capital. This traditional theory is open to criticism on two grounds: first, many industrial corporations under

modern conditions raise no funds for capital expansion through the medium of interest-bearing obligations—the reason being that shares of stock involving no interest cost provide much greater flexibility to management. Second, interest is in general a negligible element among the factors of cost.

It should be noted here that Keynes had finally become doubtful about the adequacy of the investment inducement. While the strong disposition to save would reduce money market interest rates, he believed that the productivity of new capital would diminish even more rapidly—thus leaving scant inducement to invest. Nor could government monetary policy with safety be depended upon to bring about sufficient reductions in market interest rates. "I am now somewhat skeptical of the success of a merely monetary policy directed toward influencing the rate of interest."

(2) Keynes adhered to the classical conception of the declining productivity of additional units of capital. He assumed that the added physical units of capital have merely the same effectiveness as those they replace and that since they are applied to natural resources under conditions of diminishing returns, the productivity of additional units necessarily declines. Nowhere in his book does one find any reference to technological progress and the ever-increasing productivity which results from constantly improving capital instruments. When one recognizes the fact that new capital units are usually much better than old, . . . the outlook is completely altered.

Notwithstanding the extraordinary and continuous increase in productivity in modern times, made possible by science and technology, Keynes' position in 1936 was almost identical with that of John Stuart Mill in 1848. He went so far as to say:

> A properly run community equipped with modern technical resources . . . ought to be able to bring down the marginal efficiency of capital . . . to zero within a single generation; so that we should attain the conditions of a quasi-stationary community.

LIKE THE CLASSICISTS, KEYNES SAW LITTLE CHANCE FOR CONTINUED ECONOMIC PROGRESS

Since he adhered to the classical conception that additional capital inevitably means declining productivity, he was preoccupied with *equilibrium* in a virtually stationary industrial society. Starting with a condition of under-employment in time of depression, his analysis led him to conclude that as employment and income expand, the lag in consumer demands tends to prevent private enterprisers from pro-

viding full employment. If, by chance, in some period of business buoyancy, we should attain full employment, the situation would quickly be undermined by the growing disparity between consumption and savings.

Keynes' reasoning thus led him to a dead-end street so far as private enterprise is concerned. Despairing of the latter, he looked to the government and to public enterprise as the primary source of new investment and employment.

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KEYNES' PESSIMISM RESTED ON A MISCONCEPTION OF THE PRIMARY SOURCE OF EXPANDING SAVINGS

Since in his view the over-all ratio of savings to spending is determined by the low propensity of the *average* man to consume, with a consequent tendency for savings to increase, it appeared impossible to correct the maladjustment, that is, to reduce the percentage of the national income saved. On the contrary, as the wealth of a nation increased, the evil, in his view, could only be progressively aggravated.

But when one discovers from budget studies showing the savings made at different levels of income that the *primary* factor affecting the savings ratio is the increasing concentration of income in the hands of the wealthier classes, it is easy to see how the spending-saving ratio may be improved. It might obviously be brought about by a reduction in the number and magnitude of high incomes—by means of taxation or otherwise. More important, as a continuing process, a reduction in the savings ratio may result from a constantly broadening distribution of *newly generated* income, made possible by technical advances.

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A RESORT TO GOVERNMENT SPENDING WOULD NOT SOLVE THE BASIC PROBLEM POSED BY KEYNES

A growing disparity between consumption and saving would not be corrected by a government spending program. An expansion of income resulting from government activity would have precisely the same effect as an increase of income flowing from private activity. Keynes did not attempt to show that, when the masses derive income from government sources, the "fundamental psychological law"—that is, the allegedly weak propensity to consume—is altered. Indeed, he recognized at one place that the fundamental difficulty remains even with government spending.

Moreover, there is no reason to assume that a substitution of government capital expansion for private capital expansion would overcome the inevitable tendency (as Keynes saw it) toward declining productivity. The additional units of public capital might well be even less productive than new units of private capital. So long as one adheres to the classical assumption with respect to the declining productivity of additional capital, economic progress is obviously impossible—whatever the form of economic organization. A static society is the most that can be anticipated.

It should be added that Keynes did not face the long-run fiscal implications of the resort to government spending. Unlike many of his followers, he did not specifically contend that an ever-increasing public debt is of no consequence. This fundamental long-run issue was simply ignored.

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CAPITAL AND INTEREST

FRANK H. KNIGHT

THE CONCEPT OF CAPITAL is peculiarly difficult to explain briefly, because of its intimate relationships with other types of wealth and sources of income, and because of the changes in meaning which all the main concepts used in economic analysis have undergone in the history of the science. Particularly in the past generation or so, this development has made scientific usage quite divergent from that of everyday life.

HISTORICAL BACKGROUND. In the main tradition of "classical" economics, not to go farther back, capital has generally been described as produced wealth used for further production. . . . This definition distinguished capital on the one hand from land or natural resources,

supposedly unproduced, and on the other hand "consumption goods." It was also taken for granted that "wealth" should not include human beings, though, in contrast with the later social viewpoint, the earlier writers inclined to treat the working population as a means to political ends or power. Analysis soon came to be built explicitly around the notion of three "factors of production," labor, land, and capital, supposed to correspond with the three recognized forms of income, wages, rent, and "profit." The progress of investigation has tended to make the conception of capital less definite and more inclusive.

* * * *

Modern Views. Contemporary economic thought with respect to capital and its return is still controversial, but the view which seems to be gaining predominance may be sketched out. First of all, production is defined in relation to economic equilibrium, a conception due primarily to J. B. Clark, in the form of a stationary economy. This is a hypothetical society in which capital is maintained without increase or decrease, while population and wants and the "state of the arts" are also unchanging, and all economic adjustments have been carried to a position of stability. Under these conditions, production consists in using "productive agents" of all kinds in a relationship of symmetrical cooperation, to provide an unvarying stream of consumable services or satisfactions as the ultimate product. The production of the services consumed in any period of time includes the maintenance of all productive agents and materials used in the economy, including in turn the replacement of any which are worn out or used up. Thus under equilibrium conditions production and consumption are simultaneous. And where investment or disinvestment intervenes, there is no determinate relation in time between the two. In a progressive economy (in the sense of increased production without change in wants or productive methods), production further includes a net addition to the productive equipment through saving and investment, and exceeds consumption by this amount. In a retrogressive economy (in the same sense) consumption would exceed production, the difference representing a decrease in the total productive equipment, through "dissaving" and disinvestment. Thus the fundamental meaning of "real" capital is simply productive equipment viewed as subject to quantitative increase or decrease. The theory as a whole pictures distribution of the product among different types of productive agents through imputing to each unit of each type the value of the "increment" of total product which is finally dependent upon the cooperation of any one small unit of that type of agent, or "factor." This is the

"marginal productivity" theory of distribution. The theory describes the position of equilibrium for the economy as a whole, which can also be pictured as moving with change in the given conditions.

In this new setting, the problem of the classification of productive agents appears in a different light. The traditional "tri-partite" division into three factors, labor, land and capital, loses much of its significance, as does the distinction between producers' and consumers' goods or wealth. As already indicated (and as Professor Irving Fisher in particular has emphasized) the major analytical distinction is that between "income" consumed or saved, and "sources" of (or agents which yield) the services which compose income. All sources are properly productive agents, and are also "capital goods" in the most inclusive meaning. In practice, it is often useful to restrict the notion of capital goods in various directions, and the definition will depend on the problem considered in any particular piece of exposition. Some four or five main lines of restriction may be significant. First, human beings (in "free" society) are not capital in the same sense as property which is regularly bought and sold. Second, "intangibles," including many types of claims upon sources or their earnings, are in a different case from physical sources themselves. Within the class of tangible goods (third) some are used directly for consumption, others indirectly to make other goods. Further, (fourth) some are immediately destroyed in use (food, fuel, chemicals, etc.) while others last and render their services over periods of time of almost any length. Finally, among goods of substantial durability, some are used by those who own them while others are used by a second party, under various contractual arrangements between owner and user. In all these cases there are grounds for restricting the appellation of "capital" to one or the other member of the comparison and many sub-classes or differences in degree may be recognized.

With respect to the organization of production, and hence for the purpose of general theory, the durability of sources (the fourth distinction) is particularly important, because it largely determines the length of time that will be required to convert an agent of one type into one of another type, suitable for a different mode of use, in response to a change in the demand or in technology. The speed of such transfers also depends on the time required to produce the new form of source. Again, as already indicated, only goods of a minimum durability can be used by parties other than their owners, or their services be bought and sold apart from the sources themselves.

As already observed, the general and fundamental meaning of real capital includes all sources or objects which have productive capacity, the quality of rendering valuable (and scarce) services of any

sort. For theoretical analysis, the essential matter is the distinction between such objects, or "capital goods," and "capital," i.e., productive capacity, viewed in abstract quantitative terms, as subject to increase or decrease, hence transferable from one use to another through change in form, i.e., decrease of one kind and increase of another. Thus the problem is one of measurement or quantification of productive capacity. This, in turn, is a matter of valuation, since value is the only common denominator between different economic forms. The market enables an individual to change his investment position through changing places with another, and the prices guide the process of real investment and transfer of investment in the economy. Where there is no market for an agent, as in the case of free human beings, or where the price is indeterminate because of imperfect competition, the data which enter into market price may enable computation of a value, or a more accurate one, as the case may be. The economic importance of capital does not depend on exchange, and still less on the borrowing and lending of money, but on the fact that changes in production are effected chiefly through disinvestment and reinvestment. Only to a limited extent can productive agents be moved from one use to another without being changed in form in this way, though in a progressive economy, proportional changes are largely effected through directing new investment into fields where relative expansion is called for.

Reflection upon the process by which production in any line is extended through investment, or contracted through disinvestment, will make clear the reason for the "passing" of the three-factor classification of productive agents. There is no general difference between any two of the three traditional classes—laborers, natural agents and capital goods—with respect to the possibility either of transfer from one use to another "as they stand" or of increase or decrease. We find all degrees of freedom of investment and disinvestment, hence replacement of any kind by any other. And also all degrees of substitutability of one physical kind for others in the production of the same (or an equivalent) consumable service.

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THE RELATION BETWEEN INTEREST AND RENT. Only historical accident or "psychology" can explain the fact that "interest" and "rent" have been viewed as coming from different sources, specifically natural agents and capital goods. The difference is clearly one of contractual form, or even of arbitrary "point of view." If one person, A, hires from another, B, the use of any piece of property whatever, the payment will be called rent. It is quite immaterial whether the prop-

erty itself is land or anything else, whether it is natural or artificial, tangible or intangible, or is used for production or consumption. Houses, furniture, and even some articles of clothing, are regularly leased for a rental, as well as farms or building sites; and the same is true of patents, though under certain forms of contract the payment is called a "royalty." The lessee in such an arrangement always has the alternative of borrowing money and buying the object, and insofar as competitive conditions prevail, the two forms will be exactly equivalent for both parties. The user may borrow the money from the previous owner, as regularly occurs in the case of real estate; and if the use is wanted for a limited time, the object can be sold and the loan paid off. Thus every lease could be replaced by a sale, and vice versa.

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Capital Goods and Laborers. Similar considerations apply in substance to the laborer and his wages as to land and rent. Though, for "human" reasons, laborers are not usually referred to as "means of production," they are economically similar to other productive agents. The difference is "institutional"; in a slave economy laborers of all classes would be merely species of capital goods. This of course was largely the case in parts of the U. S. A. within the lives of people still living. There usually are, indeed, important differences; sentiment and social usage, including religion, cause human slaves to be treated in a somewhat different way than work animals, or machines. Important economic differences arise in the control of reproduction and the rearing of children. However, all these things are matters of detail and of degree, and similar distinctions exist between many categories of capital goods. The procurement of slaves, through raids, or purchase from peoples who themselves recognize slavery, has commonly been hardly more influenced by sentiment than other investment operations.

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Present-Day Theory of Capital and Its Return. The essential phenomena of capital center in the necessity for maintenance and replacement of productive agents and the possibility of disinvestment and of further investment in practically any form, old or new. Every economically active person must constantly apportion productive capacity under his control between use to yield a larger current stream of want-satisfying services and the maintenance, improvement or creation of productive agents with a view to a larger flow of such services in the future, or to still further investment. There is little difference among physical classes of resources with respect to this choice.

And further, roughly speaking, all kinds cooperate in making every kind, including human beings endowed with all varieties of earning power. Accordingly, modern thought is abandoning the distinction between primary and secondary, produced and unproduced, or reproducible and non-reproducible agents. The distinction between human beings and property and that between personal and real property are important in law and human relations, but no fundamental economic differences correspond to them. The original fallacy was probably rooted in the "moral prejudices" that only labor is really productive, and that land is a gift of nature. Realistic economic analysis must avoid any general classifications of productive agents and make distinctions on the basis of the facts that are significant for the problem in hand. For general analysis, it would be desirable to drop also the traditional classification of income forms, and to speak of the yield and "hire" of productive agents, irrespective of kind.

Accurately speaking, investing or disinvesting involves a comparison between consuming income in the immediate and the more remote future, rather than in the "present" versus the future. To avoid technicalities which can only be dealt with by the mathematics of "continuously compounded" interest, we may think of an investment made and completed within an interval short enough to be treated as a moment of time, and which immediately begins to yield a return. The yield itself may of course be either consumed or wholly or partly invested; the latter use corresponds to the facts in a progressive economy or economic unit of any kind but the same form of choice is involved in deciding between maintenance of the stationary condition and retrogression.

For both simplicity and realism, it is best to approach the rate of return on any income source by considering that the possibility of investment and disinvestment makes any future income, however distributed in time, equivalent to a perpetual and uniform annual flow. What any source actually produces in any interval of time is its imputed yield for that interval, reduced by whatever amount may be necessary to provide for maintaining the source itself intact, including routine maintenance and eventual replacement, thus converting the yield into a perpetuity. (This allowance must be made in identifying the "rent" or "hire" of any productive agent with the "interest" on the investment in it, since rent contracts more commonly make maintenance and replacement the responsibility of the owner and include these costs in the rent paid; in legal language, the property is to be returned in its original condition except for "ordinary wear and tear and unavoidable accident.") The annual rate of yield is the ratio between the annual value of the perpetuity and the investment in the

source. Under conditions of perfect competition, or in an economic system in the position of the theoretical equilibrium (stationary or moving), all sources would yield a uniform rate of return on their cost of production, which would be equal both to their cost of reproduction and their market value. The essential principle is that under ideal conditions—which include perfect knowledge and foresight—existing resources will be so apportioned between the use to yield current satisfactions and the investment use, and among all forms of both, as to make this rate uniform, for the whole economy at the highest level which can be obtained under existing technical and other circumstances. Under real conditions, this rate "tends" to be approximated at the margin of new investment (or disinvestment), with allowance for the uncertainties and errors of prediction. But existing sources will be valued by "capitalizing" their expected income yield (or of disinvestment, in a retrograde society). In other words, their value will be the market estimation of the minimum cost of producing any source which will yield the same income in perpetuity. The expected yield of any source during its life may itself be affected by its durability or by the time required to carry out investment in new forms expected to yield an equal income at lower cost.

The Rate of Interest. It must be evident that if borrowing and lending of money occurs in a situation where opportunity for productive investment is open, the rate of interest on loans will tend to be equal to the theoretical rate of yield on real investment. An intelligent man will not make a loan at a rate lower than he could secure by investing his capital himself—with allowance for uncertainty and for trouble and expense in the two cases; and the borrower for productive purposes will naturally not pay a higher rate than his investment is expected to yield. The lender in this case becomes in effect the owner of the new assets in the amount required to produce the income which he receives as interest, together with additional security. Finally, if loans are made for purposes other than productive investment, i.e., for consumption, competition will tend to fix the same rate on these. If the concepts are carefully defined, loans for consumption purposes are not very different from loans for productive investment, since they involve a lien upon assets—if the borrower gives security, as he must if the transaction is really a loan. And the case is not essentially changed if the transaction is a means to disinvestment more rapid than the owner could effect through under-maintenance. In a progressive society, particular cases of disinvestment, however carried out, are best viewed as a small deduction from the net growth of capital in the economy as a whole.

The Psychological Factor. The argument of the preceding section seems to make the marginal productivity of capital the causal determinant of the rate of yield, and so of the interest rate. This conclusion is essentially correct, but its establishment depends on further argument; what has been said shows merely the necessity of equality, leaving the question open as to which determines the other or whether both are determined by some other cause. We referred earlier to the controversy between productivity theorists and others who have explained the rate of return in "psychological" terms, meaning an alleged general human preference of present over future satisfactions of like kind and amount. (Both groups follow Böhm-Bawerk, who also suggested a third "ground" of interest, but it cannot be explained briefly, and discussion would show it to be unimportant if not unreal.) "Time-preference" or "discount of the future" as an independent explanation has been advocated especially by Professor F. A. Fetter in the U.S.A. and Professor L. von Mises in Vienna. Essentially, the theory is the "abstinence" doctrine of Senior and J. S. Mill; but the writers of the British classical school never attempted to use the degree or intensity of abstinence to explain the actual rate of yield or of interest. The neo-classical economists (following Marshall) usually combine productivity and time-preference in an eclectic or equilibrium theory, using the one to yield a demand curve and the other a supply curve. The most elaborate and careful development of this view is found in the work of Professor Irving Fisher.

The issue in interest theory is parallel to that involved in the controversy between "cost of production" and "utility" theories of general price determination, which was also set in motion by the Austrians and other writers of the subjective-value school. It was finally recognized that neither marginal cost nor marginal utility directly determines price. At equilibrium, any two prices must be in the same ratio as both of the other pairs of magnitudes, because the economic behavior of producers and consumers will make all three ratios equal. The process of adjustment must be considered in two steps. First, every consumer buys products, at prices which he finds given, in such proportions as to equalize the marginal satisfaction secured from equal increments of expenditure; and market competition sets the prices that will "clear the market" of the existing or momentarily forthcoming supplies. Second, entrepreneurs and owners of productive agents adjust production, at given prices of both products and productive services, so as to equalize costs and selling prices, and competition fixes the prices of productive services at the levels which will clear the market of the existing or forthcoming supplies of these. Equaliza-

tion in both fields—prices proportional to utilities and equal to costs —defines the condition of general equilibrium. We must remember that the prices of productive services are at the same time the incomes of consumers, one factor in the effective demand for products. In a still longer view account must be taken of changes in the supply of productive agents and in technology and consumers' tastes, in a theory of historical economic change or progress (Marshall's "secular changes").

* * * *

Money and Capital. The question whether money should be treated as capital is one of the most difficult aspects of the general problem. It also involves the meaning and role of money, and the forces which determine its value. Money is clearly capital to the individual owner, though its value to living in any theory (except the psychology of the miser) depends on its future purchasing power. Its value may bear nearly any relation to that of the money material (or metallic "reserve"), its cost of production or its utility in non-monetary uses. In the case of a metallic currency, with free and unlimited coinage, these values are equal; but the bulk of a nation's medium of exchange, or even all of it, may consist of paper or bank credit of little cost or intrinsic worth. Money is also capital from the standpoint of the exchange economy as a whole, in the sense that it is one of the vital instrumentalities of organized economic life, virtually a necessity. But the amount of money, or of wealth in that form, that is "required" depends on the conventionally established timing of payments, as well as on prices and the volume of economic activity. Hence the amount of money which should be included in an estimate of the aggregate wealth of a society is a question which admits of no definite answer.

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THE NATURE OF PROFITS

JOSEPH A. SCHUMPETER

Entrepreneurial profit is not a rent like the return to differential advantages in the permanent elements of a business; nor is it a return to capital, however one may define capital. So that there is no reason for speaking about a tendency towards equalisation of profits which does not exist at all in reality: for only the jumbling together of interest and profit explain why many authors contend for such a tendency, although we can observe such extraordinarily different profits in one and the same place, at the same time and in the same industry. We want finally to emphasize that profit is also not wages, although the analogy is tempting. It is certainly not a simple residuum; it is the expression of the value of what the entrepreneur contributes to production in exactly the same sense that wages are the value expression of what the worker "produces." It is not a profit of exploitation any more than are wages. However, while wages are determined according to the marginal productivity of labor, profit is a striking exception to this law: the problem of profit lies precisely in the fact that the laws of cost and marginal productivity seem to exclude it. And what the "marginal entrepreneur" receives is wholly a matter of indifference for the success of the others. Every rise in wages is diffused over all wages; one who has success as an entrepreneur has it alone at first. Wages are an element in price, profit is not in the same sense. The payment of wages is one of the brakes to production, profit is not. One might say of the latter, but with more right, what the classical economists asserted of rent of land, namely that it does not enter into the price of the products. Wages are a permanent branch of income, profit is no branch of income at all if one counts the regular recurrence of a return as one of the characteristic features of income. It slips from the entrepreneur's grasp as soon as the entrepreneurial function is performed. It attaches to the creation of new things, to the realiza-

tion of the future value system. It is at the same time the child and the victim of development.

Without development there is no profit, without profit no development. For the capitalist system it must be added further that without profit there would be no accumulation of wealth. At least there would not be the great social phenomenon which we have in view—*this* is certainly a consequence of development and indeed of profit. If we neglect the capitalisation of rents and saving in the narrow sense of the word—to which we ascribe no very big role—and finally the gifts which development in its repercussions and chance throw in the lap of many individuals, which it is true are in themselves temporary but which may lead to the accumulation of wealth if they are not consumed, then by far the most important source of the accumulation of wealth still remains, from which most fortunes spring. The non-consumption of profit is not saving in the proper sense, for it is not an encroachment upon the customary standard of life. And so we may say that it is the entrepreneur's action that creates most fortunes. It seems to me that reality convincingly substantiates this derivation of the accumulation of wealth from profit.

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THE MAINSPRING OF INDUSTRY

FRED ROGERS FAIRCHILD

PROFITS ARE INCENTIVE, SIGNPOSTS, MEANS. (1) *Incentives.* Investors and business men seek profits. They know that the way to get profits is to produce the things that the people want and offer them at prices that the people are willing to pay. And they know that competition will see to it that the rewards, on the whole, go to those who best succeed in accomplishing these ends.

Entrepreneurs are thus led to conduct their businesses with intelligence, skill, and integrity. They are impelled to discover and experiment with new inventions, improved methods, new processes. The primary object of all this is to cut down unit costs of production. When costs are reduced, selling prices can be lowered, sales volume increased, and profits gained.

But reducing the costs of present products is not all. Progressive entrepreneurs are always seeking opportunity to introduce some new product that will better satisfy a present need, or even to stimulate new wants. To do this requires the breaking of fresh ground. There is no assurance in advance that people will be interested in the new product; no one can tell in advance what it will cost to make it, or whether the people will consider it worth a price that will cover its cost.

All this is uncertain; it involves risk. Yet it is only by someone taking the chance, risking his time and his capital and the capital of others entrusted to him, that economic progress is made. Thus it was that society gained the railroad, the telephone, the automobile, the electric range and washing machine. In fact, a hundred years ago pretty nearly everything we enjoy today was either not known or in a form less capable of serving us. For these accomplishments of this century there had to be something to induce men of ability and courage to undertake industrial leadership and assume its risks. That is the role of profit.

(2) *Signposts.* Profits are more than the inducement to assume the risks of business. They are also the arbiters, or signposts, that determine the direction of industry. Part of the entrepreneur's function is to decide where to direct the employment of capital and labor. If at any time the prospect of profits from making and selling automobiles looks better than average, more capital and labor will be directed into the automobile industry. If profits from the production of something else are falling off, capital and labor will leave, or at any rate new investment will shun this field.

In short, the quest for profits continually impels the entrepreneurs to make decisions as to what the people want and leads them to direct capital and labor into the several lines of production in such proportions as will most effectively meet the people's needs.

(3) *Means.* Profits also provide the means for expanding or improving those enterprises which demonstrate superior efficiency in meeting the wants of consumers. The way in which reinvested profits are put into new buildings, new equipment, and additional materials has been described in the preceding section. Either as profits retained in the business, or as reinvested savings from dividends paid out to stockholders, profits are the chief source of the capital growth which

is essential for increasing production, expanding employment, and raising wages.

Thus the hope of profit is the inducement to assume the guidance and the risks of enterprise, and profits are the reward of the entrepreneur who succeeds. By and large the size of the reward is in proportion to the service rendered in supplying human needs. The superior producer gains the superior profit. He has served the public well. He is encouraged and enabled to do better. In this way progress is made toward the maximum satisfaction of human wants and the highest possible standard of living, with minimum cost in human effort and sacrifice.

Changing the Odds. Now comes the ability theory, proposing that those firms that appear especially prosperous shall be called upon to submit to an estimate of their future profits, and that on the basis of this estimate they shall be compelled at once to raise their wage rates.

What does this do to the profit motive?

Under a free economy, it is to be presumed that the existing prospect of profits is sufficient inducement to lead men to perform the entrepreneurial function of planning, organizing, and risk bearing. By the same token, it is no more than sufficient; competition sees to that. We have noted the facts of actual profits and seen that in the long run the total of profits and losses presents a very moderate net amount. In other words the American entrepreneurs have been willing to perform their function and bear the risks of enterprise for an uncertain reward at odds only a little better than fifty-fifty.

Now it is proposed to change the odds. The entrepreneur must still bear the losses of his unsuccessful ventures, the number of which will be enlarged by the advance commitment to increased wage rates. Yet he is to be deprived of the full reward of those that succeed. If the present hope of profits is just about sufficient inducement to lead the entrepreneur on, the diminished hope will not be good enough.

But, it may be asked, are not the wage demands to be limited to those firms that are especially prosperous? Can't they stand it? Why should this prospect deter investment and the assumption of business risk?

In answer we observe, first, that there is no assurance that the wage rise would be restricted to the more prosperous concerns. We have seen how unstable is a condition of different wage rates for the same kind of labor. After forcing the more prosperous firms to raise wages, the pressure to bring up the rest would probably be irresistible.

In the second place, let us not forget the essentially speculative nature

of the whole process. We can tell which are at any given time the prosperous concerns. But it is future wages that are to be set. How do we know what firms will be prosperous over the future months and years to which these wage rates will apply? Even with the best of intentions, there can be no assurance that it would actually be the prosperous concerns that would bear the high wage rates.

Finally and more fundamentally, the occasional large profits are not pathological abnormalities; they are an essential part of the free enterprise system. In the course of the business cycle, there are years in which industry generally is doing well; the average of profits is high. But such periods always alternate with years of depression, when there are many and large losses and low average profits. A certain succession of good times and bad is a necessary characteristic of the economic progress which characterizes free enterprise, and only free enterprise. It is one of the basic conditions that make industry risky. The larger profits of the good years are required to balance the smaller profits or losses of other years. Only by combining the prospects of both good years and bad can the entrepreneur see odds sufficiently favorable to induce him to assume the risks of enterprise. The prevailing custom of balancing the income account at the end of each twelve month period is after all highly artificial for most businesses. Only by combining the experience of several years can business results be conclusively determined.

In like manner, there are at almost any time particular firms that are making large profits, out of line with the prevailing average. This also is inherent in the nature of a progressive economy. Where risks are small, profits are generally small, and so are losses. These are the safe, conservative lines of industry. But economic progress requires launching out also into the untried and speculative. Here risks are great. There is the chance of heavy loss; there must also be the chance of large profit. For some concerns the chance may turn out favorably, with handsome profits the result. But we must not overlook those other firms to whom chance has been unkind, with sad results of bankruptcy, failure, and loss. The large profits of the successful concerns are required to balance the losses of the others. Or to put it a little differently, the entrepreneur, considering embarkation on the uncertain sea of business venture, must have the prospect of large profits to offset the prospect of large losses. Otherwise he will consider the odds not good enough.

The Broken Mainspring. When the profit motive is destroyed, we have broken the mainspring of the mechanism of free enterprise. Economic leadership is rebuffed.

What now is the use of planning, experimenting, and taking chances in the quest for lower costs of production, if the profits resulting from success are to be the special target of attack?

What now is the use of seeking out the lines whose products will be most acceptable to the people, if no hope of reward in proportion to the risk is held out?

Why try the new and untested, at special risk, when the chance of special profit is denied in advance?

Suppose it were announced that hereafter the more successful businesses would be required to pay higher prices for materials, higher freight rates, higher interest rates on their borrowed capital, or higher rentals. Paying higher wages would be no different in its discouraging effect.

The industrial machine cannot operate without leadership and the bearers of risk. Yet it is proposed to withdraw or curtail the inducement that thus far has led the leaders to enlist.

PART SIX

National Income Analysis

This Part begins with Theodore Morgan's account of the uses of the national-income concepts (82). Richard Ruggles and J. R. N. Stone discuss national income as a guide for policy-makers (83). Number 84 is one of the celebrated series of letters which J. M. Keynes directed to President Roosevelt during the Great Depression. Number 85, by the same author, considers the public reaction to "wasteful" and "partly wasteful" expenditures. Paulo Sylvos Labini offers some criticisms of Keynesian economics in Selection 86. A classical statement of "underconsumption" by John A. Hobson constitutes Reading 87. An account of business cycles over a long span of years is given in Article 88 by James Arthur Estey. Number 89 is Wesley C. Mitchell's conspectus of business fluctuations in the United States (1790–1925), a fascinating device for "judging" American political administrations by scientific economic standards. Alvin Hansen's account of the business cycle is reprinted in Number 90. The early history of index numbers, by Wesley C. Mitchell, appears as Reading 91. A Federal Reserve Bank article on the "hazards" of forecasting constitutes Reading 92. Thorstein Veblen's explanation of conspicuous consumption and the leisure class is offered in Number 93. A governmental study on patterns of spending and saving (94) closes this Part.

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THE USES OF NATIONAL-INCOME CONCEPTS

THEODORE MORGAN

WE HAVE EMERGED FROM OUR INQUIRY with three measures of production, income, or expenditure (we can use the terms interchangeably): (1) gross national product or expenditure at market prices, (2) net national product or income at market prices, and (3) net national product or income at factor prices. Finally, we have (4) disposable income of individuals, which is not a measure of production.

If we are concerned only with percentage changes, it often does not matter greatly which of these measures we use, since they are usually highly correlated with each other. But if we are concerned with amounts, or amounts of change, then it is important to distinguish among them.

THE GROSS NATIONAL PRODUCT

1. The gross national product has three special uses.

(a) For short-term studies of perhaps a decade or less, gross national product is a useful, perhaps the most useful, measure of a country's production. In such a short period, the total of *all* goods and services produced may carry the most significance. The fact that some of this gross output must eventually go to make good depreciation can be partly or entirely neglected. Our buildings and equipment must be replaced eventually, but not necessarily now.

(b) The gross-national-product concept of the Department of Commerce, which we have followed, measures the revenues from sales of all businesses taken together (with adjustments for inventory changes) plus the cost value of government production. Hence it is also a measure of gross or total expenditure by all spending agencies for produced goods and services: by all consumers, businesses (which

buy plant, equipment, and inventories), and government bodies. An especial usefulness arises through including in our measure of national product these gross expenditures of business and the total expenditures of government. (Both of these can be figured on a smaller or net basis; and they are both so taken in the net-product-at-factor-prices concept.) It is useful to take them "gross" if we feel—as we do—that they are, so figured, strategically important variables for explaining short-term changes in the economy. The gross-national-product concept arises inherently out of the view that these are variables of crucial importance.

(c) We possess no acceptable measure of the total of all transactions in which money figures in the economy—the total of all payments, gifts, and loans—although we know this total is several times larger than the value of the gross national product. Nevertheless a series for all transactions, with which to compare the flow of money in the economy, would be very useful. The gross national product is the most significant stopping point between net national income and total transactions, and, in reasoning about monetary matters, can often be used as a substitute for the latter.

THE NET MEASURES OF INCOME AND PRODUCTION

1. The net income or product at factor prices both take into account the obvious fact that plant and equipment are wearing out as production proceeds. Therefore both concepts fit the basic meaning of income in an economy as the maximum that can be used up out of production without the economy's becoming poorer in productive capacity.

2. Net income or product at market prices values production at the prices confronting the buyer in the market place, and so best represents the changing situation of buyers of goods. It is, therefore, the best measure of production to use in questions concerned with the trend of economic welfare.

But net national income at market prices includes within it *indirect taxes*. And whether the government gets its revenues from indirect taxes or from other sources bears little relation to the part government takes in production. More exactly, indirect taxes bear little relation to the value of government services facilitating production by private businesses, as compared with the value of direct production by government of final goods and services.

3. Therefore, for matters concerned with the productivity or resources of the economy, net national income at factor prices is the preferable tool. For example, if we want to see what possibilities exist for shifting resources from one use to another, or to measure the con-

tribution of different industries, or to consider the problem of inequality of income, we shall be concerned with aspects, or components, of the net national income at factor prices (or simply, the national income).

4. We still have to consider one measure, not indeed of production, but of income. This is disposable income of individuals. It is the money income (with minor qualifications) that individuals actually receive; and so is the most significant total to use when we want to carry through a psychological inquiry relating the incomes of individuals to their consumption expenditures and their savings.

THE EARNING AND SPENDING OF INCOME

Several useful relationships are implicit in our national-income measures. The presence of government expenditures and taxes in the economy introduces a complication, but this we temporarily neglect.

THE EARNING AND SPENDING OF INCOME, NEGLECTING THE PLACE OF GOVERNMENT

Expenditures for the production of the economy can be divided into two classes: expenditures for goods and services which are *not* used in any further production, and expenditures for goods which *are* used in future production. The former we call *consumption* goods and services (food, clothing, haircut, recreation equipment, and the like). The latter are called *investment,* or *capital* goods.

The only purpose of investment goods is to aid in the eventual production of consumption goods and services.

1. The largest proportion among investment goods is *fixed capital,* which consists of buildings and equipment of various sorts—drill presses, open-hearth furnaces, factory buildings, railroad engines and tracks, cement mixers, calculating machines, and so forth.

2. An addition to inventories (stocks of raw materials or goods in process or finished products) is like an addition to fixed capital in that labor and other resources have gone into the inventories, and in that eventually the inventories will become available in some form as consumption goods and services. In both cases, labor and other resources have been employed, without obtaining any immediate increase in the quantity of consumer goods and services available.

3. Net exports, which means value of exports minus value of imports, is similar to investment at home: we are using labor and other resources to build up a claim on foreigners, which claim can in the future be transformed into consumption goods and services. The debt

that the foreigner owes us can be turned eventually, for example, into imported woolens and wines. In somewhat the same fashion, a miller's inventory of wheat becomes transformed into flour, and finally into bread; and the railroad's locomotives become transformed, over their life span, into ton-miles of transportation.

Since we have divided all of production into the two divisions of consumption and investment, all the incomes earned in production must arise from these same two sources: from consumption expenditure and investment expenditure.

Income *equals* Consumption *plus* Investment.

Income can be disposed of in two ways: it is spent on consumption goods and services (this is the consumption expenditure we have already listed above), or else it is not spent on consumption goods. We call that part of income which is not spent on consumption *savings*. Hence,

Income *equals* Consumption *plus* Savings.

Since the national income is equal both to consumption plus investment, and to consumption plus savings, it must be that savings always equals the value of investment:

Savings *equals* Investment.

If we consider as investment the total production of investment goods in the course of any period (say, a year), we have what is called *gross investment.* Suppose that from this gross figure we subtract those investment goods which serve to replace other investment goods that have completely depreciated—that is, become worn out or obsolete. The remainder is *net investment,* the net addition to the economy's supply of investment goods resulting from the production of the year.

Our above reasoning to the effect that savings always equals investment holds whether we are speaking in terms of gross investment and gross savings or in terms of net investment (gross investment minus investment goods that have become worn out and obsolete) and net savings (gross savings minus depreciation allowances).

We can demonstrate this equality between savings and investment in a different way. We will speak in terms of net savings and net investment. Our savings over any period of time consist of the value of the additions we have made to our property during that time. Property takes three forms: money, securities, and physical goods. But money is either a security (the note of a bank or of the government), or a physical good (gold, silver, copper). We are left with only two

categories. Securities, in turn, are debts owed by one person or institution to another, and for every dollar's asset in the form of a security which someone holds, someone else owes a dollar. Hence, *within* the economy, securities cancel out to zero. But if there has been trade with foreigners, and on balance the people of the economy are owed more (less) by foreigners, this portion of the securities does not cancel out.

We are left with physical goods and the excess of exports over imports. Our net savings have turned out to be (1) the value of the increase in the physical goods of the country—additions to plant and equipment, additions to inventories of goods, plus (2) any addition that may be made to claims on foreigners. But the sum of these two is what we have already called net investment.

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NATIONAL INCOME AS A GUIDE FOR POLICY-MAKERS

RICHARD RUGGLES and J. R. N. STONE

ALTHOUGH NATIONAL INCOME accounting is by itself in no sense a sufficient basis for formulating economic policy, it is of use in helping to answer certain questions about overall economic policies. These questions, specifically, are of three major types:

1. Is the policy which is being considered capable of being achieved in terms of the availability of resources?
2. How does the policy affect the operation of the economy in terms of prices, output, and employment?
3. What is the net effect of the policy in quantitative terms? Is it worth doing?

Each of these questions will be examined in turn.

(1) *Economic policy and the availability of resources.* It might seem that almost any policy which advocates increased output somewhere in the economy is basically a good policy, since increased goods and services are a desirable goal. But, when the problem is considered in the context of the potentially usable resources in the economy, it is apparent that advocating an increase in one particular industry is tantamount to declaring that it will be more beneficial to use additional resources in this industry than in any other industry.

For a valid defence of the policy, it would be necessary to show what additional resources would be needed to carry it out, from what part of the economy such resources could be obtained, and why this particular use would be more beneficial than alternative use of these same resources in other industries.

For all of these questions, the information available in the national income accounts is pertinent. The quantity of additional resources needed to carry out an economic policy cannot be computed without regard to inter-industry relationships. Should an increase in naval construction be proposed it is not enough to consider the increased manpower required for actual construction. The manpower and facilities involved in the component industries, in the steel industry, in coal mining, and even in industries as far removed as chemicals and electric power must also be considered.

With a knowledge of the general requirements of the programme, the national income accounts show the relative expansion in the output of these industries, or the contraction in the use of their products by other industries, which would be needed to carry the programme forward.

Alternatives to the proposed policy should also be considered in a similar manner—for instance, in this case it would be useful to study the cost, in terms of economic dislocation of air fleets. The usual comparison in money cost terms alone is not enough. Some parts of the economy cannot easily expand further, whereas other parts may actually be operating below capacity. To insure the fullest possible utilization of resources such factors as these should be taken into account, and the final economic policy which is recommended should be based on the explicit belief that it is superior to all possible alternatives.

A second major group of economic policies are those which refer to the economy as a whole and are quite general in their coverage. An economic policy of this type is only meaningful if it fits within the limits of the existing resources of the economy, and if it is internally consistent. The production of food will not increase at the same rate as the production of steel or even textiles. The rate at which different

industries grow is governed by the manner in which the consumer spends his income, the kinds of goods and services which are purchased by the government, and the nature and level of the capital goods industries.

Further differences in rates of growth are introduced by technological factors; the ability to utilize mass production permits some industries to operate at decreasing cost, whereas the limitation of available resources prevents expansion in others. Inventions and changes in technology also complicate the situation for almost all industries.

Because of these complexities met in analyzing overall economic growth, the governments of most countries in which national accounts are available use these accounts to make projections of the effects they believe their economic policies will have. These projections are frequently referred to as "national budgets"; in effect they show the change that is to be expected in each part of the economy.

Since these projections of the national accounts are usually presented in terms of constant prices, the separate accounts will only balance and tie in with each other if the net increase in output does not exceed the assumed change in available resources. The making of the projection therefore insures that the projected changes will be within the expected potential limits of the resources.

Using the national accounting system to integrate the effects of an overall economic policy with the economy as it exists and as it is expected to change in the future, it becomes possible to see whether the proposed economic policy is consistent with itself and whether it can be expected to produce a result superior to those of alternative general economic policies.

(2) *Economic policy and the operation of the economy*. Badly designed economic policies can result in serious inflations or depressions, so that it is necessary to give careful consideration to the relation of any proposed policy to the actual functioning of the different sectors of the economy. An example will demonstrate the use of national accounts for this purpose.

Consider a proposal to reduce the public debt. Suppose that the actual mechanism proposed is increased taxation of individual incomes in order to obtain a government surplus to be used for debt repayment. Further let it be assumed, for the sake of concreteness, that most of the debt repayments would be to banks holding government bonds. Making use of the sector accounts, it is possible to trace through the effects of both the increase in taxation and the debt repayment.

On the personal income and expenditures account, the amount of personal taxes paid would increase, and individuals would be forced to

curtail their personal savings or their consumers' expenditures. Since every entry appearing on the account of one sector also appears on another account in the economy, it is necessary to look at the other accounts to see how they will adjust to the changes in consumers' expenditures.

In the national allocations and expenditures account, consumers' expenditures must be reduced by the same amount that these expenditures were reduced in the personal income account. This of course means that the total for all expenditures (i.e., gross national product at market prices) must also be reduced, and it follows that if the account is to balance the allocations will have to change simultaneously.

In all probability, as a result of the decline in consumers' expenditures producers will receive fewer orders, and they will therefore cut back production, causing some unemployment. The decrease in wages and salaries in turn must be entered on the personal income account, as a decline in personal income. Individuals will undoubtedly react to this decline in their incomes by cutting their expenditures again, and again producers will sell less and so be forced to dismiss more workers, increasing unemployment. Debt repayment to the banks will not necessarily help the situation. The debt repayment represents a current payment by the government, but it does not represent a current payment *of income* to anyone in the economy. There is no reason to believe that producers will borrow to expand their investment expenditures merely because the banks now have cash instead of bonds. The more probable development is that with the initial declines in consumers' expenditures and in output and employment, producers will curtail their investment expenditures, so leading to an even sharper decline in gross national product, output, and employment. The use of national income accounting thus reveals that this economic policy designed in this particular way, on the surface apparently desirable, might actually have disastrous results.

Just as a badly designed economic policy can cause a depression, so it can also result in an inflation. Suppose for example that the government, although it desired to keep the budget balanced, decides to equalize incomes somewhat by removing some of the taxes from the lower income groups and placing equivalent taxes on the upper income groups.

The immediate results of this action would appear on the personal income account as a rise in consumers' expenditures and a fall in personal saving. The lower income groups would be given larger incomes to dispose of by the tax reduction, and they would undoubtedly react by spending most of the additional money which became avail-

able to them. On the other hand, the people of the upper income groups who were now paying more taxes would have to reduce their savings in order to be able to meet the increased taxes and still maintain approximately the same standard of living.

In terms of the national allocations and expenditures account, these reactions would appear as an increase in consumers' expenditures, and, if only a limited quantity of goods were available, the prices of consumers' goods would rise. Producers, because of the increase in consumers' expenditures, would have more money to allocate over the factors of production, and more would be available to meet labour's wage demands. Personal income would therefore increase, and consumers' expenditures would again rise, starting the spiral all over again. Producers' reactions to the higher level of activity in the economy would reinforce the spiral; they would increase their expenditures on capital goods and thus further increase the gross national product.

(3) *Economic policy and its quantitative effect.* The final question that must be considered is that of the actual results which an economic policy can be expected to achieve in terms of the goals of the society. National income accounting obviously can never give a complete answer to this question. The welfare of individuals cannot be measured in terms of a few summary measures. There are many nonquantitative ingredients—such things as working conditions, freedom of opportunity, and the moral and political temper of a country.

But national income accounting can and does shed some light on what is happening to the end uses of production. The calculations of the expected expenditures on the national allocations and expenditures account in terms of constant prices will show the quantitative change which is expected to occur in the goods and services available for specific end uses. This information, even though it is by no means a complete basis for evaluating any policy, is very much needed.

Policies which have a large degree of risk attached to a small possible gain are naturally excluded from any reasonable consideration. In like manner, the expected results of an economic policy need to be estimated in quantitative terms in order that the possibility of gain may be weighed against the risks of failure. Many policies which in theory are beneficial may be found, when examined in quantitative terms, to make so little difference that they are not worth undertaking.

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AN OPEN LETTER — 1933

JOHN MAYNARD KEYNES

DEAR MR. PRESIDENT:

You have made yourself the trustee for those in every country who seek to mend the evils of our condition by reasoned experiment within the framework of the existing social system.

This is a sufficient reason why I should venture to lay my reflections before you, though under the disadvantages of distance and partial knowledge.

You are engaged on a double task, recovery and reform—recovery from the slump, and the passage of those business and social reforms which are long overdue. For the first, speed and quick results are essential. The second may be urgent, too; but haste will be injurious, and wisdom of long-range purpose is more necessary than immediate achievement.

The object of recovery is to increase the national output and put more men to work. In the economic system of the modern world, output is primarily produced for sale; and the volume of output depends on the amount of purchasing power, compared with the prime cost of production, which is expected to come on the market.

Broadly speaking, therefore, an increase of output cannot occur unless by the operation of one or other of three factors. Individuals must be induced to spend more out of their existing incomes, or the business world must be induced, either by increased confidence in the prospects or by a lower rate of interest, to create additional current incomes in the hands of their employes, which is what happens when either the working or the fixed capital of the country is being increased; or public authority must be called in aid to create addi-

tional current incomes through the expenditure of borrowed or printed money.

In bad times the first factor cannot be expected to work on a sufficient scale. The second factor will only come in as the second wave of attack on the slump, after the tide has been turned by the expenditures of public authority. It is, therefore, only from the third factor that we can expect the initial major impulse.

Now there are indications that two technical fallacies may have affected the policy of your administration. The first relates to the part played in recovery by rising prices. Rising prices are to be welcomed because they are usually a symptom of rising output and employment. When more purchasing power is spent, one expects rising output at rising prices. Since there cannot be rising output without rising prices, it is essential to insure that the recovery shall not be held back by the insufficiency of the supply of money to support the increased monetary turnover.

But there is much less to be said in favor of rising prices if they are brought about at the expense of rising output. Some debtors may be helped, but the national recovery as a whole will be retarded. Thus rising prices caused by deliberately increasing prime costs or by restricting output have a vastly inferior value to rising prices which are the natural result of an increase in the nation's purchasing power.

I do not mean to impugn the social justice and social expediency of the redistribution of incomes aimed at by the NRA and by the various schemes for agricultural restriction. The latter, in particular, I should strongly support in principle. But too much emphasis on the remedial value of a higher price-level as an object in itself may lead to serious misapprehension of the part prices can play in the technique of recovery. The stimulation of output by increasing aggregate purchasing power is the right way to get prices up; and not the other way around.

Thus, as the prime mover in the first stage of the technique of recovery, I lay overwhelming emphasis on the increase of national purchasing power resulting from governmental expenditure which is financed by loans and is not merely a transfer, through taxation, from existing incomes. Nothing else counts in comparison with this.

In a boom, inflation can be caused by allowing unlimited credit to support the excited enthusiasm of business speculators. But in a slump governmental loan expenditure is the only sure means of obtaining quickly a rising output at rising prices. That is why a war has always caused intense industrial activity. In the past, orthodox finance has regarded a war as the only legitimate excuse for creating employ-

ment by government expenditure. You, Mr. President, having cast off such fetters, are free to engage in the interests of peace and prosperity the technique which hitherto has only been allowed to serve the purposes of war and destruction.

The setback American recovery experienced this past Autumn was the predictable consequence of the failure of your administration to organize any material increase in new loan expenditure during your first six months of office. The position six months hence will depend entirely on whether you have been laying the foundations for larger expenditures in the near future.

The other set of fallacies, of which I fear the influence, arises out of a crude economic doctrine commonly known as the quantity theory of money. Rising output and rising incomes will suffer a setback sooner or later if the quantity of money is rigidly fixed. Some people seem to infer from this that output and income can be raised by increasing the quantity of money. But this is like trying to get fat by buying a larger belt. In the United States today your belt is plenty big enough for your belly. It is a most misleading thing to stress the quantity of money, which is only a limiting factor, rather than the volume of expenditure, which is the operative factor.

It is an even more foolish application of the same ideas to believe that there is a mathematical relation between the price of gold and the prices of other things. It is true that the value of the dollar in terms of foreign currencies will affect the prices of those goods which enter into international trade. In so far as an overvaluation of the dollar was impeding the freedom of domestic price-raising policies or disturbing the balance of payments with foreign countries, it was advisable to depreciate it. But exchange depreciation should follow the success of your domestic price-raising policy as its natural consequence, and should not be allowed to disturb the whole world by preceding its justification at an entirely arbitrary pace. This is another example of trying to put on flesh by letting out the belt.

These criticisms do not mean that I have weakened in my advocacy of a managed currency or in preferring stable prices to stable exchanges. The currency and exchange policy of a country should be entirely subservient to the aim of raising output and employment to the right level. But the recent gyrations of the dollar have looked to me more like a gold standard on the booze than the ideal managed currency of my dreams.

If you were to ask me what I would suggest in concrete terms for the immediate future, I would reply thus:

You have three alternatives. You can devalue the dollar in terms

of gold, returning to the gold standard at a new fixed ratio. This would be inconsistent with your declarations in favor of a long-range policy of stable prices, and I hope you will reject it.

You can seek some common policy of exchange stabilization with Great Britain aimed at stable price levels. This will be the best ultimate solution; but it is not practical politics at the moment, unless you are prepared to talk in terms of an initial value of sterling well below $5 pending the realization of a marked rise in your domestic price level.

Lastly, you can announce that you will control the dollar exchange by buying and selling gold and foreign currencies at a definite figure so as to avoid wide or meaningless fluctuations, with a right to shift the parities at any time, but with a declared intention only so to do either to correct a serious want of balance in America's international receipts and payments or to meet a shift in your domestic price level relative to price levels abroad.

This appears to me your best policy during the transitional period. You would be waiving your right to make future arbitrary changes which did not correspond to any relevant change in the facts, but in other respects you would retain your liberty to make your exchange policy subservient to the needs of your domestic policy—free to let out your belt in proportion as you put on flesh.

In the field of domestic policy, I put in the forefront, for the reasons given above, a large volume of loan expenditure under government auspices. It is beyond my province to choose particular objects of expenditure. But preference should be given to those which can be made to mature quickly on a large scale, as, for example, the rehabilitation of the physical condition of the railroads. The object is to start the ball rolling.

I put in the second place the maintenance of cheap and abundant credit, in particular the reduction of the long-term rate of interest. The turn of the tide in Great Britain is largely attributable to the reduction in the long-term rate of interest which ensued on the success of the conversion of the war loan. This was deliberately engineered by the open-market policy of the Bank of England.

I see no reason why you should not reduce the rate of interest on your long-term government bonds to 2½ per cent or less, with favorable repercussions on the whole bond market, if only the Federal Reserve System would replace its present holdings of short-dated Treasury issues by purchasing long-dated issues in exchange. Such a policy might become effective in a few months, and I attach great importance to it.

With these adaptations or enlargements of your existing policies, I should expect a successful outcome with great confidence. How much that would mean, not only to the material prosperity of the United States and the whole world, but in comfort to men's minds through a restoration of their faith in the wisdom and the power of government!

With great respect,
Your obedient servant,
J. M. KEYNES

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"WASTEFUL" AND "PARTLY WASTEFUL" EXPENDITURES

JOHN MAYNARD KEYNES

IT IS CURIOUS how common sense, wriggling for an escape from absurd conclusions, has been apt to reach a preference for *wholly* "wasteful" forms of loan expenditure rather than for *partly* wasteful forms, which, because they are not wholly wasteful, tend to be judged on strict "business" principles. For example, unemployment relief financed by loans is more readily accepted than the financing of improvements at a charge below the current rate of interest; whilst the form of digging holes in the ground known as gold-mining, which not only adds nothing whatever to the real wealth of the world but involves the disutility of labour, is the most acceptable of all solutions.

If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coal-mines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tried principles of *laissez-faire* to dig the notes up again (the right to do so being obtained, of course, by tendering for leases of the note-

bearing territory), there need be no more unemployment and, with the help of the repercussions, the real income of the community, and its capital wealth also, would probably become a good deal greater than it actually is. It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing.

The analogy between this expedient and the gold-mines of the real world is complete. At periods when gold is available at suitable depths experience shows that the real wealth of the world increases rapidly; and when but little of it is so available, our wealth suffers stagnation or decline. Thus gold-mines are of the greatest value and importance to civilisation. Just as wars have been the only form of large-scale loan expenditure which statesmen have thought justifiable, so gold-mining is the only pretext for digging holes in the ground which has recommended itself to bankers as sound finance; and each of these activities has played its part in progress—failing something better. To mention a detail, the tendency in slumps for the price of gold to rise in terms of labour and materials aids eventual recovery, because it increases the depth at which gold-digging pays and lowers the minimum grade of ore which is payable.

In addition to the probable effect of increased supplies of gold on the rate of interest, gold-mining is for two reasons a highly practical form of investment, if we are precluded from increasing employment by means which at the same time increase our stock of useful wealth. In the first place, owing to the gambling attractions which it offers it is carried on without too close a regard to the ruling rate of interest. In the second place the result, namely, the increased stock of gold, does not, as in other cases, have the effect of diminishing its marginal utility. Since the value of a house depends on its utility, every house which is built serves to diminish the prospective rents obtainable from further house-building and therefore lessens the attraction of further similar investment unless the rate of interest is falling *pari passu*. But the fruits of gold-mining do not suffer from this disadvantage, and a check can only come through a rise of the wage-unit in terms of gold, which is not likely to occur unless and until employment is substantially better. Moreover, there is no subsequent reverse effect on account of provision for user and supplementary costs, as in the case of less durable forms of wealth.

Ancient Egypt was doubly fortunate, and doubtless owed to this its fabled wealth, in that it possessed *two* activities, namely, pyramid-building as well as the search for the precious metals, the fruits of which, since they could not serve the needs of man by being consumed, did

not stale with abundance. The Middle Ages built cathedrals and sang dirges. Two pyramids, two masses for the dead, are twice as good as one; but not so two railways from London to York. Thus we are so sensible, have schooled ourselves to so close a semblance of prudent financiers, taking careful thought before we add to the "financial" burdens of posterity by building them houses to live in, that we have no such easy escape from the sufferings of unemployment. We have to accept them as an inevitable result of applying to the conduct of the State the maxims which are best calculated to "enrich" an individual by enabling him to pile up claims to enjoyment which he does not intend to exercise at any definite time.

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THE CASE AGAINST KEYNES

PAULO SYLVOS LABINI

THE KEYNESIANS have a right wing and a left wing; both alike insist on their orthodoxy and both alike make the Master say things of which he never even dreamt. Keynesianism is, in short, a full-fledged philosophic school. Instead of theses and anti-theses there are the "propensities." "Liquidity preference" has replaced the Idea.

The government departments at Washington are full of Keynesians of all tendencies. Their prescriptions vary with prevailing economic conditions (Keynes's system is wonderfully elastic); it is always easy to demonstrate that the conditions are those one wishes them to be.

Are the trade unions taking a threatening attitude, and do wage rises seem inevitable? Wage rises are advantageous: Keynes says so and so do the left-wing Keynesians.

Does it seem possible to withstand the demands for wage rises?

Other Keynesians (the right wing) pop up, waving other writings of the Master showing that such rises are an evil.

Is the budget deficit alarming and does the Party in power need to fillip its popularity? It is found that the marginal efficiency of capital is too low to attract savings to investments; it is necessary to tax the rich, whose propensity to save is dreadfully high. But maybe the rich show their teeth: it is not advisable to attack them. It will then be discovered that the marginal efficiency of capital is high enough; there is no danger that money remain in the drawers; heavier taxation would be a serious mistake.

Then, there are the "findings" generally accepted, the "conquests" of the new economists.

The economic horizon darkens: is a depression in sight? Well and good: the time has come for wildcat finance (technically known as "deficit spending"). What should be financed? Public works, armaments, perhaps even social services.

All this of course is garbed in dignified scientific terms, and claims the respect of all, if it is seasoned with estimates of disposable incomes and global savings with calculations of the various "propensities" and "multipliers."

Keynes takes no cognizance of the problem, on which good classical economists laid so much stress, of what is "productive" and what "unproductive," *i.e.,* what is "luxury," or, we may say, of what is socially productive and what is not. For him one investment is as good as another, since it means spending.

All will be well, provided people spend; and should savers keep their money in their drawers, then the government must do the spending. It does not much matter whether the money is spent on building an electric power station or on paying people to carry water from the Atlantic to the Pacific. A Keynesian (an assistant professor of economics at Harvard), to whom I made this objection, answered me: "but, as we know, Keynes's theory only holds good for the short run; and in the short run investment expenditure has the effect of raising the wage level and increasing employment whatever the investment may be."

This famous "short run" is always brought forward by the followers of Keynes. "In the long run we are all dead." But before dying we shall be living a rather wretched life if we go on committing a series of "short run" follies.

Keynes ignores not only the problem of social productivity but also, and consistently, that of costs. That costs be high or low, that they be rising or falling, matters little to him. He thinks that, in the short run, technological changes can be quietly ignored; and he has not even a

suspicion that these changes may account for many of those disequilibria that he tries to explain by "propensities," "multipliers" and other economic gadgets.

The fundamental objection is this: Keynes has failed to understand the part played by the banks in modern life, and this failure undermines the whole construction of his logic.

Each person, says Keynes, may spend his money-income on consumption goods, or he may save it; if he saves it, he may invest or he may hoard it.

Men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income. The ratio between the increase in the consumption of a community and the increase of its income—the marginal propensity to consume, dC/dY is less than unity. If the aggregate income grows, savings grow in actual figures and perhaps also proportionately. (The richer, moreover, have a lower propensity to consume than the poorer. The more unequal the distribution of income, the wider the margin of savings, which may or may not be invested).

A new expenditure on consumption goods increases aggregate income and employment; new individual savings increase both the one and the other only in so far as they are invested. Those who save are induced to lend only if they obtain an adequately high rate of interest. Interest is the price paid to induce savers to renounce holding liquid money. Now, who pays this interest? It is paid by the firms, whose demand for loans and whose investments vary according to the more or less high marginal efficiency of capital (or, as Lerner corrects, of investments, because, according to another "famous" remark, a *fund* should not be confused with a *flow*).

And here I come to the core of the argument.

If the marginal efficiency of capital falls, the total investment declines. Effective demand (the sum of outlays for consumption and of those for investments) falls below the level ensuring full employment, and therefore the social income shrinks. Under these conditions, Keynes says, no automatic mechanism assures the return of full employment and raises again the income.

The decline in the rate of interest, which according to the "classics" might re-establish the balance, does not really do so. The fact is that interest depends on "liquidity preference," which, for various reasons, increases, or does not decline; and as money cannot be "produced" by the individuals, the price of money, *i.e.* the rate of interest, increases, or is reluctant to fall: the "inducement to invest" is hampered. Things, left to themselves, may remain like this for a long time. Nor, under

these circumstances, will the reduction in money wages be helpful, as such a reduction may lead to a further shrinkage of effective demand.

There is but one way to react: to stimulate effective demand, that is to say, the mass of money flowing into consumption and investments. How? The monetary authority may immit new money, especially by "open market operations": the additional money lowers the rate of interest and thus encourages investment. Or the monetary authority may directly reduce the rate of interest. Besides, the government itself may raise its expenditures, by financing public works or other "investments."

This reasoning is based on the assumption that the volume of money is constant. This assumption, Keynes says, is legitimate because, in the case of a gold-standard currency, metallic money can be produced by private enterprise in gold-mining countries in a measure which, for the world as a whole, is negligible; in the case of an inconvertible managed currency, paper money can be "produced" only by the monetary authority, that is to say by the central bank under public control, and not by private enterprise. Should the liquidity preference grow, and with it the rate of interest, the production of money cannot increase, as, for instance, the output of motor cars can increase if their price rises.

Here is the fallacy. The "production" of means of payment, in the modern economic process, did not and does not depend, substantially, on the mines or, respectively, on the monetary authority; it did and does not depend on the banks (and among them there is the central bank itself in so far as it does not operate under public control), which all emanate from private enterprise, that is to say from the firms.

It is not true that the firms cannot "produce" money: they can and do produce it: not directly, but through the banks, which in their turn are themselves firms. This means that the banks, continuously, create means of payment on behalf of the non-banking firm. (We do not say that they "create credit," an expression which has given rise to many misunderstandings.) These means of payment have only a very elastic connection with individual savings.

Strictly speaking, the means of payment "created" are not and do not represent the savings of anyone. (Regarded from the social standpoint, they may lead to "forced" saving, in as much as they bring about a rise in prices; or they may hypothetically hinder an expansion of consumption in as much as they prevent a price fall.)

The commercial banks—I am referring to these—obtain on loan 100 monetary units from individual savers and have to pay a certain rate of interest to overcome—let us use this expression—their "liquidity preference"; but they make loans for 200, 300 units or more; and to

obtain these loans the entrepreneur has not to overcome any "liquidity preference" of the banks, which indeed (subject to certain ample limits taught by experience and the circumstances of the time) prefer "illiquidity."

Keynes's arguments could hold good, if at all, in an economy with a purely metallic currency, or in one in which the circulation consisted of bank-notes with a full metallic cover, in which the banks merely acted as middlemen for private savings. But, two centuries ago at least, such an economy ceased to exist.

My Keynesian friend reflects; and then says that my objection might be valid in the case of circulating capital, which is financed by bank loans; but not in that of fixed capital, which is financed by shares and debentures. These are purchased by individual investors; and here we are forced to take into account their preferences and propensities.

This line of defence cannot hold. A net distinction between the two sources of financing, corresponding to the two types of capital, is a purely scholastic one. It is well known that firms often finance long-term investments with short-term bank loans, which they renew several times. Moreover, share and debenture issues are usually financed, at least in a first stage, by the banks, either directly or by loans made to brokers.

My friend rebuts: but in the last resort those securities must be purchased by individual investors. Agreed. But we are justified in supposing that these investors purchase those securities with means of payment which in the period under consideration, brief though it may be, have been created by the banks and have come into their hands by various ways. From this point of view also, the assumption that the volume of money is constant would seem to be unfounded, or, rather, deceptive. Such an assumption creates bottle-necks, requires passages, which in reality do not exist.

In short, what Keynes at the conclusion of his drama wants the banks (or the government) to do, *i.e.*, to augment the volume of money in circulation, is what the banks are normally doing. If at a given moment the banks find difficulty in continuing to do so, if, against their will, they see their liquid reserves increasing, this does not depend on ill-will on their part, and still less on the unwillingness of the individual savers to loan money. It depends on the fact that the prospects of profits decline, and are replaced by prospects of losses; it depends on the fact that the "marginal efficiency of capital" falls. Why does this efficiency fall? This still has to be explained: the wreckage of the Keynesian edifice offers no answer.

Does this mean that in periods of depression all monetary manage-

ment should be condemned? Or that all forms of government intervention should be banned? Of course not. It only means that as a matter of correct reasoning Keynes's theory must be discarded; let him who will try to build up another. But if we aim at correct reasoning, then we cannot accept Keynes's theory, even if we like his political conclusions.

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UNDERCONSUMPTION

JOHN A. HOBSON

WE MAY SAY that a rapidly rising technique and improved organisation have undoubtedly led to a rapid increase of the productive power of industry. But the inability to make full profitable use of this increased power must be imputed to a failure to make a full, continuous use of the purchasing power created and distributed simultaneously with every act of production. This failure, again, can only be imputed to a maldistribution of income of such a kind as to place too much purchasing power in the hands of the richer classes, who allow it to accumulate for investment, too little in the hands of those who desire to raise their standard of living. The necessary effect is to evoke a monetary saving which is found to be excessive, in that the increased goods it is intended to produce cannot actually get produced, because there is an insufficient market for them. A better and more equal distribution of "surplus" income is thus seen to be necessary to give full continuous employment to capital and labour in an economic system whose productive technique is constantly enlarging the productive powers of the community.

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THE RECORDS OF BUSINESS CYCLES

JAMES ARTHUR ESTEY

IT HAS BEEN POINTED OUT that, although business cycles are not periods, they are properly described by the term *cycles* and are, therefore, capable of being measured. Such measurement must be obtained from the records of cyclical fluctuations wherever they may be found, reaching back as far as possible and into all countries of the world.

The records of business fluctuations, at least in the recognizable pattern of recurrent ebb and flow of activity, do not in all probability extend back of the Napoleonic Wars. It is true that all economic life in the past, as far as records go, has been subject to many vicissitudes and changes, but the kind of fluctuation to which the term *business cycle* applies seems essentially to be a characteristic of relatively recent industrial history, more particularly of that modern industrialism which has developed since about the time of the Napoleonic Wars.

The economic records of the past show good times and bad times. They show many crises. But these variations of economic activity do not take on the recurring rhythm of cycles. They do not arise from characteristics inherent in, and forces developed by, the world of business.

In his minute study of English business from 1558 to 1720, Dr. William R. Scott of St. Andrews has discovered 30 crises during this period of time. Characteristically, they are due, principally, to the following causes: famines, plagues, wars, civil disorders, irregularities of government finance, high-handed acts of government, early speculation (such as the South Sea Bubble of 1720). Most of these alleged "causes" play little part in modern cycles. The older crises, moreover, were apt to be of long duration. One fifth of them lasted three years or more. Modern crises tend to be short. Whole cycles are ended in three or

four years. In earlier times, crises did not necessarily follow periods of prosperity; 12 of the 30 came in periods of depression. Modern crises tend to follow periods of prosperity, for the reason that prosperity induces stresses and strains that bring it to an end. Again, whereas modern crises are brought about by factors inherent in the nature of our business process, the older crises were seemingly precipitated by nonbusiness factors and could, therefore, occur at any time. They tended to be isolated, unpredicted disturbances and produced an irregularity of sequence such as is not characteristic of the fluctuations of modern business activity. Essentially they were "occurrences of the unforeseen."

One may conclude that business cycles are a phenomenon of a highly developed business civilization, and that the earlier English crises "were not business crises of the modern type and that the intervals between these crises were not occupied by business cycles."

Some time in the late eighteenth century, in all probability, crises brought on by nonbusiness factors begin to give way to crises that are part of a regularly recurring cycle, and are brought about by the various circumstances in the cycle itself. Just when this occurred is a matter of doubt and speculation. For example, Tugan-Baranowski (*Les Crises Industrielles en Angleterre*) holds that what we would call "business cycles" began with the English crises of 1825. He regards the crises that marked the close of the Napoleonic Wars, 1811, 1815, and 1818, as nonperiodical, attributable to the war, and properly to be grouped with the "nonbusiness" crises of the eighteenth century. On the other hand, Bouniatian (*Geschichte der Handelskrisen in England 1640-1840*) calls the crisis of 1793 the first of England's great industrial crises followed by a general business depression. One might argue that the sensational panics following the collapse of John Law's Mississippi Company in France and the South Sea Bubble in England (1720) were to some extent forerunners of the modern crisis, possibly marking in some way the transition from the old nonbusiness crisis to the modern business cycle. While these speculative excesses did not arise out of the production and distribution of commodities and had no inherent connection with the general business system, they did on the other hand spread beyond the circle of speculation and had notable effects on business activity, raising commodity prices and stimulating industrial production and building activity.

Probably the arrival of business cycles cannot be precisely dated, but it is certain that their first definite and undeniable appearance occurs in England at the beginning of that modern period ushered in by the end of the Napoleonic wars. This occurrence is highly characteristic, for it was England which, by that time, was beginning to

display the essential characteristics of modern industrialism and what Mitchell calls "a fully developed business economy." It is in this business economy where "a large proportion of the people begin to rely on making and spending money in a large proportion of their activities" that recurrent alternations of prosperity and depression slowly begin to appear.

In a society where the economic life is centered in the family; where production is for the family, not for the market; and where the guide to activity is immediate need, not prices or the stimulus of profit, business economy is lacking. It is a subsistence economy, and subsistence economies do not appear to generate cycles. In such an economy, there is no reason that would encourage people, nor any force that would compel them, to vary their activities from year to year; no reason why economic activity should be very active for a few years and then very dull for a few years. In such a society there would be variations of output, but they would not arise from the business activity of the people. They would be the result of agricultural vicissitudes—would arise from good or bad crops and other vagaries of nature.

Simple agricultural communities, living off the soil, with little surplus, would be of this sort. In all countries, the agricultural community, so far as it is engaged in simple farming, is not particularly exposed to business cycles. More exactly, the activities of agricultural communities do not fall into the pattern of the business cycle, although of course they may be, and in fact are, affected by the variations in activity in "business" as such.

But when a large part of the population makes a living by making money, producing goods for wide markets, using credit and a widespread credit and banking system and organizing their enterprises on a relatively large scale with many employees, then business cycles seem to become a necessary part of their economy.

In this sense, business cycles are a function of what has come to be called "modern capitalism." It is characteristic that cycles appeared first in the countries having the most highly developed capitalistic system; and, conversely, that the least capitalistic countries today are affected to the least extent by such cycles; and that, even in the countries where business cycles make their most noted appearance (as, for example, the United States), the occupations and industries least affected by the characteristic processes of modern capitalism seem at the same time to be least exposed to the fluctuations of the business cycle—such occupations, for example, as agriculture, retail trade, personal service, and the handicrafts.

Thus it was that England experienced business cycles before the

United States. In the United States, the early periods of prosperity and depression were derived largely from agrarian conditions, and cycles, as we know them, had to await the great and characteristic growth of industrialism that followed the Civil War. Carl Snyder holds that

> . . . it was not until the development of steam power, the wide use of coal and iron, and the extraordinary burst of mechanical invention which followed, that modern industry, and therefore modern trade, could arise. It was from these that the business "cycle" was born.

Up to the 1840's, the United States had only "rudimentary experience" with business cycles. The panic of 1837 was essentially a financial and banking episode. Railway construction, canal traffic, tonnage of merchant marine, and coal and iron production were affected little. Prior to the 1840's, such waves of prosperity and depression as appeared were largely years of plenty or dearth in the yield of farms. Even the panic of 1857 was largely a financial and banking convulsion rather than the beginning of a serious industrial depression. The advent of the unmistakable business cycle, in the modern sense, appears to Snyder to date about the late 1860's.

Germany's cycles emerged with the unification of the Reich and the industrialization of its economic structure following the Franco-Prussian War. It is illuminating that France, which has remained to such a large degree the home of small-scale business and industry, as well as the least capitalistic types of agriculture, has been less affected by business cycles than her contemporaries, the United States, Great Britain, and Germany. In the countries which are least developed in this type of capitalistic, money-making, business economy—China, India, Brazil, South Africa, Russia (at least before the Revolution)—the fluctuations are produced, as of old in England, more by "non-business" than by business causes. Droughts, floods, epidemics, and civil disorder are more likely to be the disturbing causes. When fluctuations of the more modern type occur in these countries, they are found in those areas which have been most exposed to the money-making organization—as, for example, the coast cities of China.

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CONSPECTUS OF BUSINESS FLUCTUATIONS IN THE UNITED STATES, 1790-1925

WESLEY C. MITCHELL

1790	Revival; prosperity
1791	Prosperity
1792	Prosperity; financial distress
1793	Prosperity
1794	Uneven prosperity
1795	Prosperity
1796	Recession; depression
1797	Depression; panic
1798	Depression
1799	Revival
1800	Prosperity
1801	Mild prosperity
1802	Recession
1803	Mild depression
1804	Revival
1805	Prosperity
1806	Prosperity
1807	Prosperity; recession
1808	Depression
1809	Depression
1810	Revival
1811	Moderate prosperity
1812	Brief recession; uneven prosperity
1813	Prosperity
1814	Prosperity; financial distress
1815	Prosperity; panic; recession
1816	Depression
1817	Mild depression
1818	Mild depression
1819	Severe depression; financial panic
1820	Depression
1821	Depression; revival
1822	Mild recession
1823	Revival
1824	Prosperity
1825	Prosperity; panic; recession
1826	Depression; revival
1827	Moderate prosperity
1828	Prosperity; recession
1829	Depression; revival
1830	Moderate prosperity
1831	Prosperity
1832	Moderate prosperity
1833	Prosperity; panic; recession
1834	Mild depression
1835	Revival; prosperity
1836	Prosperity
1837	Prosperity; panic; recession; depression
1838	Depression; slight revival

1839	Revival; panic; recession
1840	Depression
1841	Depression
1842	Depression
1843	Depression; revival
1844	Revival; prosperity
1845	Prosperity; brief recession
1846	Recession; mild depression
1847	Revival; prosperity; panic; recession
1848	Mild depression; revival
1849	Prosperity
1850	Prosperity
1851	Prosperity
1852	Prosperity
1853	Prosperity; recession
1854	Recession; depression
1855	Depression; revival
1856	Prosperity
1857	Prosperity; panic; recession; depression
1858	Depression
1859	Revival
1860	Prosperity; recession
1861	Mild depression; revival
1862	War activity
1863	War activity
1864	War activity
1865	Boom; recession
1866	Mild depression
1867	Depression
1868	Revival
1869	Prosperity; monetary difficulties
1870	Recession; mild depression
1871	Revival; prosperity
1872	Prosperity
1873	Prosperity; panic; recession
1874	Depression
1875	Depression
1876	Depression
1877	Depression
1878	Depression; revival
1879	Revival; prosperity
1880	Prosperity
1881	Prosperity
1882	Prosperity; slight recession
1883	Recession
1884	Depression
1885	Depression; revival
1886	Revival
1887	Prosperity
1888	Brief recession
1889	Prosperity
1890	Prosperity; recession
1891	Depression; revival
1892	Prosperity
1893	Recession; panic; depression
1894	Deep depression
1895	Depression; revival
1896	Recession; depression
1897	Depression; revival
1898	Revival; prosperity
1899	Prosperity
1900	Prosperity; brief recession
1901	Prosperity
1902	Prosperity
1903	Prosperity; recession
1904	Mild depression; revival
1905	Prosperity
1906	Prosperity
1907	Prosperity; panic; recession; depression
1908	Depression
1909	Revival; mild prosperity
1910	Recession
1911	Mild depression
1912	Revival; prosperity
1913	Prosperity; recession
1914	Depression
1915	Revival; prosperity
1916	Prosperity
1917	Prosperity; war activity
1918	War activity; recession

1919	Revival; prosperity
1920	Prosperity; recession; depression
1921	Depression
1922	Revival; prosperity
1923	Prosperity; recession
1924	Mild depression; revival
1925	Prosperity

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THE BUSINESS CYCLE

ALVIN HANSEN

If this view is correct, if the violence of the cycle and even the continuance of the cycle is dependent upon fresh disturbing factors such as technical inventions, new resources, new markets, new products, new habits of consumers, crop fluctuations, wars, etc., what of the future of business cycles? Is it safe to conclude that the leading disturbing factors are weakening?

So far as the discovery of new resources are concerned, it seems doubtful that the world will ever again witness so significant an event as the exploitation of the resources of America. Never again will the human race have another opportunity to exploit such a large rich continent. In this respect the nineteenth century bids fair to become unique. The discovery and exploitation of America's rich resources were dynamic factors of the first magnitude. In comparison the backward countries that remain to be developed can be absorbed into the industrial system with less shock and dislocation.

In the second place, while the era of inventions and technical innovations is far from over, yet with the elaborate and complicated modern technical plant already established, no future inventions are likely to have such large disturbing effects as the railroads, for example. It is one thing to have the old technique swept away completely by the

steam engine and the railroad; it is quite a different thing for the highly developed machine industry to absorb piecemeal new inventions and improvements. During the nineteenth century Europe and America suffered the birth pangs of a violent transition from a rural order to an industrialized economy.

In the third place, we are reaching a period in which the influence of weather conditions and crop fluctuations have less disturbing effects. And this for three reasons: first, because the whole world is now tied together with a network of swift communications, so that failures in one region are balanced by good harvests in another; secondly, because agriculture has become more diversified; thirdly, because agriculture plays a much smaller role relatively in the modern order.

In the fourth place, although wars still remain to cause profound dislocations of industry, possibly when the whole world is brought into the industrial system, when economic imperialism has run its course, this disturbing factor will be minimized.

Finally, business men are gradually accumulating experiences which help them to meet and evade the disturbing factors inherent in the modern system of production. The organization of industry, says Spiethoff, will more and more fit itself to the requirements of the capitalistic manner of industry. The modern means of gaining information, the growing publicity with respect to new opportunities, make for better insight into and control over economic conditions and create a "powerful corrective when men dare too much and lose themselves in excesses." Social control, trade associations, and Kartells, and the control exercised by centralized banking systems are illustrations of an increasing social adjustment to the capitalistic method of production and the money economy. Laissez-faire is gradually being displaced more and more by purposeful and scientific control, not only with respect to discount policies but also with respect to trade competition and intertrade relations. Voluntary associations, even more than governmental regulations, are working in the direction of greater business stability.

In the last century and a half the capitalistic manner of production has suffered from many "children's diseases," to use Spiethoff's phrase. The exploitation of vast new resources, revolutionary inventions and technics, crop fluctuations in a world still largely dependent upon agriculture, wars, and an uncontrolled credit economy—these are the major disturbing influences that have produced, in the last century and a half, feverish booms and depressions. These dynamic factors are being mitigated, and so the character of the business cycle is changing. The violence of the oscillations of the business cycle during the last hundred

and fifty years is the result of a rapidly growing capitalism. In the end it may well be that the cycle phenomenon itself, at least in its extreme manifestations, will be seen to have been a disease which came and passed in the few swift centuries during which the world was made over from a rural, local economy to a highly industrialized world economy. Yet the difficulties of a stable equilibrium in such a complicated order are so great that one must remain skeptical with respect to the feasibility of a genuinely stablized economic order.

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THE EARLY HISTORY OF INDEX NUMBERS

WESLEY C. MITCHELL

THE HONOR OF INVENTING the device now commonly used to measure changes in the level of prices probably belongs to an Italian, G. R. Carli. In an investigation into the effect of the discovery of America upon the purchasing power of money, he reduced the prices paid for grain, wine, and oil in 1750 to percentages of change from their prices in 1500, added the percentages together, and divided the sum by three, thus making an exceedingly simple index number. Since his book was first published in 1764, index numbers are over 150 years old.

It was in England, however, where practically the same device had been hit upon by Sir George Schuckburg-Evelyn in 1798, that the theory and practice of index numbers were chiefly developed. The generation that created the classical political economy was deeply interested in the violent price fluctuations that accompanied the Napoleonic wars and the use of an irredeemable paper currency from 1799 to 1821. Several attempts were made to measure these fluctuations, and in 1833 G. Poulett Scrope suggested the establishment of a "tabular standard of value."

Interest in the study of price fluctuations lagged somewhat in the forties; but the great rise of prices after the Californian and Australian gold discoveries started fresh investigation. W. S. Jevons in England and Adolf Soetbeer in Germany gave a powerful impetus to the theoretical discussion and the practical computation of index numbers. The problem changed somewhat in form but received even more attention after 1873, when a prolonged fall of prices began. In the sixties the chief aim of investigation had been to discover the relations between the rise of prices and the increased production of gold; in the seventies and eighties the chief aim was to find the relations between the fall of prices and the restrictions placed upon the free coinage of silver. The weightiest theoretical contributions of this period were made by Prof. F. Y. Edgeworth, who served as secretary of a committee appointed by the British Association for the Advancement of Science "for the purpose of investigating the best methods of ascertaining and measuring variations in the value of the monetary standard."

The problem of price fluctuations entered upon another phase when the world-wide rise of prices which began in 1896-97 had been under way for several years. After 1900, and more insistently after 1910, complaints about the rising cost of living became common in all civilized countries. Efforts to measure this increase as well as efforts to explain it multiplied.

Index numbers are both troublesome and expensive to compile. . . .

Most of the series . . . have been established but recently. The oldest —that of the *London Economist*—was begun in 1869. Sauerbeck's English series dates from 1886, Conrad's German series from 1887 (though in a sense it continues investigations made by Laspeyres in 1864), and Bradstreet's American series from 1897. Of the remaining index numbers regularly published at present, all date from years since 1899, and the majority from years since 1909.

With this increase in numbers there has come an improvement in quality. The early index numbers were made by private investigators, at irregular intervals, from such price quotations as chance had preserved. As public appreciation of the importance of measuring changes in price levels has developed, the work has more and more been assumed by financial journals and government bureaus. This shift has produced a greater measure of continuity in the series, as well as greater frequency, regularity, and promptness in the publication of the results. Even more important is the improvement in the character and the scope of the price quotations from which the index numbers are made. Whereas the individual investigator had to take what he could get in the way of data, financial journals and government bureaus can collect those current prices that are best adapted for statis-

tical treatment, and can give better assurance of the representative value of their quotations and the uniform quality of the commodities included in successive years.

This improvement in the quantity and quality of index numbers is as marked in the United States as elsewhere. Price quotations had been published with more or less care and system by various newspapers and periodicals for many years before the first effort to compile an average of price variations was made. In 1881, Mr. H. C. Burchard, Director of the Mint, made an index number covering the years 1825 to 1880 from quotations that had been printed in certain reports of the Secretary of the Treasury, supplemented by quotations from a New York newspaper. But his data were of uncertain quality and his series was allowed to lapse after 1884. After an interval of eight years, the Senate Committee on Finance authorized a more ambitious effort. Under the direction of Dr. Roland P. Falkner, the Statistician of this committee, the (then) Department of Labor made a huge collection of price quotations, running back as far as 1840, and compiled an index number including more than 200 commodities for the years 1860 to 1891, and 85 commodities for 1840 to 1891. But this also was a single investigation, and the United States did not have an index number regularly maintained year after year until the establishment of Bradstreet's series in 1897. A quasi-continuation of the Senate Finance Committee's work, covering the years 1890-1899, was prepared by Dr. R. P. Falkner, and published by the Department of Labor in March, 1900. Another short-lived series was begun by Prof. John R. Commons and Dr. N. I. Stone in the *Quarterly Bulletin* of the Bureau of Economic Research later in the same year. In January, 1910, the second continuous American series was started by *Dun's Review* and gradually carried back to 1860; the third, covering the years 1890 to date, was added by the Federal Department of Labor in March, 1902. Other series of this type were begun by Thomas Gibson's weekly market letters in 1910, by *The New York Times Annalist* in 1913, and by the Federal Reserve Board in 1918.

This activity in the making of index numbers was accompanied by a rapid growth of the literature of the subject. Among the later contributions dealing with theoretical issues, the first place belongs to the work of an American scholar, Mr. C. M. Walsh. His greatest treatise upon the *Measurement of General Expense-Value,* published in 1901, is still the most comprehensive book upon the subject. But the bibliographies that aim to cover the field now include hundreds of items, and to them must go the student who wishes a guide to further reading.

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HAZARDS OF FORECASTING

Peering into the future for a picture of business conditions as they will be even a few months hence is an essential task for effective planning, but it is also a difficult one. Even though we strain our eyes to the utmost, the picture is never clear, and if the picture should appear crystal clear it is more than likely a mirage stemming from defective vision. Forecasting is inherently hazardous: first, because all of the parts which will enter into the picture are not available no matter how carefully we search for them; and, second, because factors are always present which tend to distort our view.

One of the major handicaps in forecasting is that parts which are presently missing may become major elements in the final picture several months hence. In other words, some parts of the jigsaw puzzle are nearly always missing. It is important, therefore, that we keep this particular hazard at a minimum by locating as many of the parts of the puzzle as possible.

There is an increasing amount of business and financial information which we can draw on in attempting to supply the outline of the picture we are trying to sketch. One difficulty with much of this information is that it reflects what has happened, and with a considerable time lag. Moreover, a mass of data in itself provides only a smudge on the business horizon. To get a definite picture from this mass of information, we must have some theoretical framework to guide our analysis. And our theory or opinion as to the elements that are essential for a stable and high level of production and employment will largely determine the business picture we finally visualize. For example, is our framework centered primarily on the relation of investment to saving; an inherent tendency toward a deficiency of consumer purchasing power and under-consumption; maladjustments in production; or the relation between the money supply and spend-

ing, and the flow of goods? Even though we use the same materials, the business picture we construct will largely reflect our theory of the controlling factors shaping its course.

Even though our business picture be fashioned from the best material and from the use of the most competent theoretical knowledge available, it must be recognized that, to some extent, it will usually reflect the filling in of missing parts by assumption. Some parts of this jigsaw puzzle are beyond our range of vision—even in short-term forecasting. For example, we assume that the international situation will remain the same but it does not. The North Koreans decided to take over South Korea, the United States promptly decided to resist Communist aggression in Korea, and launched a huge rearmament program. Even though international tension indicated something like this was probable, who could have foretold that it would occur in mid-1950 instead of the end of the year or in 1951 or 1952? In internal affairs, we assume that Government policies will be thus and so, but who can foresee the steps that Government will take and when? Yet, Government policies with respect to wages, prices, taxes, debt management, credit, rearmament, and a host of other things have an important influence on production, prices, and income. We assume that people will react in certain ways—for example, that they will spend about the same proportion of the funds they have available—but it does not take a student of psychology to see that we often react in unusual ways. We may spend more than our incomes or less; and we may spend it for miniature golf, yo-yo tops, and Cadillacs instead of for more or better food, clothes, and shelter. These are only a few illustrations of the gaps the forecaster is usually compelled to fill in by assumption—and even though carefully contrived, some of his assumptions are likely to be wrong.

A second major hazard confronting the forecaster is that of maintaining the proper perspective. Great care must be exercised to avoid anything which tends to distort our vision. One danger is the tendency to interpret the future in terms of the past. "All experience is an arch to build upon" but future events are unlikely to follow exactly the pattern of the past. The valuable lesson of experience must be tempered with a sensitivity to changes which may modify events in the future. It is often difficult to determine whether apprehension over the business outlook stems from what one sees ahead or from memory of what has happened in the past.

Another difficulty in getting a clear and undistorted picture is the tendency to give undue weight to the special situation confronting the individual making the forecast. To a merchant with large inventories and lagging sales, excessive inventories probably appear to be the pri-

mary problem; to the manufacturer unable to get an adequate supply of raw materials, shortages of material appear the key factor; and to the laborer having difficulty in meeting his bills which have soared because of high prices, a lack of purchasing power appears as a serious, perhaps insurmountable, drag on production and employment. This very human tendency of viewing the prospects of the entire economy in terms of our personal situation frequently results in an improper weighting of the various elements and a distorted picture of the business outlook.

A third factor which frequently distorts our perspective is the opinion we hold when we begin our analysis. A noted writer once said, "Most of our reasoning consists of starting out with a conclusion and marshalling all of the facts we can get to support it." Normally, the business forecaster begins his analysis with at least tentative views as to the business outlook. Hence, there is a strong tendency to weight unduly the fact and the figures which support these views and to discount as relatively unimportant those which do not. We must always be on guard lest the views we start with lead us to an incorrect analysis and a distorted picture of business prospects.

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CONSPICUOUS CONSUMPTION

THORSTEIN VEBLEN

During the earlier stages of economic development, consumption of goods without stint, especially consumption of the better grades of goods,—ideally all consumption in excess of the subsistence minimum, pertains normally to the leisure class. This restriction tends to disappear, at least formally, after the later peaceable stage has been reached, with private ownership of goods and in an industrial system based on

wage labour or on the petty household economy. But during the earlier quasi-peaceable stage, when so many of the traditions through which the institution of a leisure class has affected the economic life of later times were taking form and consistency, this principle has had the force of a conventional law. It has served as the norm to which consumption has tended to conform, and any appreciable departure from it is to be regarded as an aberrant form, sure to be eliminated sooner or later in the further course of development.

The quasi-peaceable gentleman of leisure, then, not only consumes of the staff of life beyond the minimum required for subsistence and physical efficiency, but his consumption also undergoes a specialisation as regards the quality of the goods consumed. He consumes freely and of the best, in food, drink, narcotics, shelter, services, ornaments, apparel, weapons and accoutrements, amusements, amulets, and idols or divinities. In the process of gradual amelioration which takes place in the articles of his consumption the motive principle and the proximate aim of innovation is no doubt the higher efficiency of the improved and more elaborate products for personal comfort and well-being. But that does not remain the sole purpose of their consumption. The canon of reputability is at hand and seizes upon such innovations as are, according to its standard, fit to survive. Since the consumption of these more excellent goods is an evidence of wealth, it becomes honorific; and conversely, the failure to consume in due quantity and quality becomes a mark of inferiority and demerit.

This growth of punctilious discrimination as to qualitative excellence in eating, drinking, etc., presently affects not only the manner of life, but also the training and intellectual activity of the gentleman of leisure. He is no longer simply the successful, aggressive male,—the man of strength, resource, and intrepidity. In order to avoid stultification he must also cultivate his tastes, for it now becomes incumbent on him to discriminate with some nicety between the noble and the ignoble in consumable goods. He becomes a connoisseur in creditable viands of various degrees of merit, in manly beverages and trinkets, in seemly apparel and architecture, in weapons, games, dancers, and the narcotics. This cultivation of the aesthetic faculty requires time and application, and the demands made upon the gentleman in this direction therefore tend to change his life of leisure into a more or less arduous application to the business of learning how to live a life of ostensible leisure in a becoming way. Closely related to the requirement that the gentleman must consume freely and of the right kind of goods, there is the requirement that he must know how to consume them in a seemly manner. His life of leisure must be conducted in

due form. Hence arise good manners. . . . High-bred manners and ways of living are items of conformity to the norm of conspicuous leisure and conspicuous consumption.

Conspicuous consumption of valuable goods is a means of reputability to the gentleman of leisure. As wealth accumulates on his hands, his own unaided effort will not avail to sufficiently put his opulence in evidence by this method. The aid of friends and competitors is therefore brought in by resorting to the giving of valuable presents and expensive feasts and entertainments. Presents and feasts had probably another origin than that of naive ostentation, but they acquired their utility for this purpose very early, and they have retained that character to the present; so that their utility in this respect has now long been the substantial ground on which these usages rest.

* * * *

It is obviously not necessary that a given object of expenditure should be exclusively wasteful in order to come in under the category of conspicuous waste. An article may be useful and wasteful both, and its utility to the consumer may be made up of use and waste in the most varying proportions. Consumable goods, and even productive goods, generally show the two elements in combination, as constituents of their utility; although, in a general way, the element of waste tends to predominate in articles of consumption, while the contrary is true of articles designed for productive use. Even in articles which appear at first glance to serve for pure ostentation only, it is always possible to detect the presence of some, at least ostensible useful purpose; and on the other hand, even in special machinery and tools contrived for some particular industrial process, as well as in the rudest appliances of human industry, the traces of conspicuous waste, or at least of the habit of ostentation, usually become evident on a close scrutiny. It would be hazardous to assert that a useful purpose is ever absent from the utility of any article or of any service, however obviously its prime purpose and chief element is conspicuous waste; and it would be only less hazardous to assert of any primarily useful product that the element of waste is in no way concerned in its value, immediately or remotely.

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PATTERNS OF SPENDING

Over a period of years, the number of dollars that families spend for living may change a great deal. Nevertheless, at any one time the general patterns of family spending remain much the same. These patterns depend on such matters as income, family size and age, *i.e.*, the stage of the family life cycle; whether families live on farms or in cities; and the region in which they live.

When families are sorted by the amount of their income, certain points in the patterns of spending stand out:

At the lowest economic level most families cannot cover their expenditures with the year's income. Many go into debt or draw on past savings. At high income levels not all is needed to cover expenses of living, and an increasing share goes to savings or to getting ahead financially as by paying off debts.

At all income levels a large share of the total goes for food and housing, including the heat, light, and furnishings for the home, rent, and such expenses of home owners as taxes, repairs, and interest on the mortgage.

The dollars spent for food increase with income, but the share decreases from about 40 percent at the lowest levels to about 25 percent in the upper income groups.

The amounts spent for clothing, medical care, and the group of expenditures that includes personal care, recreation, and education, are larger at each successive income level. Each takes an almost constant share of income throughout the range of incomes. The share spent for automobiles and other transportation and for gifts and taxes, on the other hand, increases slightly at the higher income levels.

Spending patterns differ with age and size of family. Parents and children tend to apportion their expenditures differently as they grow

older. Growing families also have more members to care for than young couples or older parents whose children have left home.

* * * *

Young couples have relatively high expenditures for automobiles, clothing, furnishings, and equipment, and such things as personal care and recreation. On the other hand, for couples in which the wife is 60 or older, expenditures for food, housing, and household operation tend to be higher. Houses of older families often are larger, and require more heat and light. Houses occupied by older couples are more often owned, and generally more valuable than those occupied by young couples.

The number of children also affects family spending patterns. Given the same income, the larger families spend more for food and make up the difference by spending less for furnishings and equipment, the automobile, and medical care. Families with one, two, and three children averaged about the same spending for clothing—each person got a good deal less in the larger families.

Age and size of family make a difference in the amount of savings. Older couples tend to make some savings at a lower income than do other families. Families with children 16 years or older are less likely to save than are families of the same size and income whose children are younger.

. . . Incomes tend to change as families progress through the different stages of the life cycle, first increasing, then dropping somewhat.

PART SEVEN

Economics of International Relationships

THE FIRST READING, Number 95, by Sir Thomas Mun, shows how the nature of early international trade called for some aptitudes needed today and also for some which we no longer regard as essential. Even the essential aptitudes are obtained today through organization rather than through the training of one individual. Number 96 is an account by Adam Smith of what we today would call the "absolute advantage" which one nation has over another in the realm of production. Number 97 is Frank William Taussig's statement of the principle of comparative advantage and its special application to the United States. The South Carolina Ordinance of Nullification in 1832 is reprinted here as Selection 98 to show the concern about the tariff in an earlier day. Number 99 is the protest voiced by some American economists against the tariff in 1930. Foreign reaction to the same tariff is suggested in Article 100. In Number 101, Amos E. Taylor shows the fallacy of building international-trade policy on the idea that we export only 10 percent of our annual production. In Number 102, the State Department explains our foreign policy. Henry Hazlitt, in Reading 103, raises some objections to the Point-Four Program. The Government's position is shown in Number 104 and in Number 105, which tells of the effects of Point Four in Liberia. International economic problems are discussed by Percy W. Bidwell in 106. J. M. Keynes discusses the same problems in terms of the struggle for markets (107), as do Alvin Hansen (108) and Roger Auboin (109). Number 110 describes the organization of the International Sugar

Council. This reading is intended to show how the various countries of the world set up organizations dealing with basic raw materials. In Number 111, John B. Condliffe discusses some international monetary issues.

Other selections which might be read in connection with this Part are 28, 29, and 152.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged below.

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(96) Smith, Adam, *An Inquiry into the Nature and Extent of the Wealth of Nations,* Vol. I, Book IV, Ch. II, Everyman ed., Dutton.

(97) Taussig, F. W., *Some Aspects of the Tariff Question,* Harvard University Press, 1931, pp. 37–44, 45–46, 47.

(98) November 24, 1832. (Senate Doc., No. 30, 22 Cong., 2 Sess., 36–38.)

(99) Protest of 1,028 American Economists to President Hoover, *The New York Times,* May 5, 1930.

(100) Reprinted from Jones, Joseph M., Jr., *Tariff Retaliation,* University of Pennsylvania Press, 1934, pp. 113, 116.

(101) Taylor, A. E., *Studies in World Trade and Employment,* New York: Committee on International Economic Policy, 1947, pp. 105–115.

(102) *Our Foreign Policy,* Department of State Publication 3972, Govern ment Printing Office, September, 1950, pp. 4–6.

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(104) *Our Foreign Policy,* Department of State Publication 3972, Government Printing Office, September, 1950, pp. 72–78.

(105) *Point Four Pioneers,* Department of State Publication 4279, Government Printing Office, October, 1951, pp. 3–8.

(106) Bidwell, P. W., "A Commercial Policy for the United Nations," *Studies in World Trade and Employment,* New York: The Committee on International Economic Policy, 1947, pp. 56–57.

(107) Keynes, J. M., *The General Theory of Employment, Interest, and Money,* Harcourt, Brace, 1935, pp. 381–383.

(108) Hansen, Alvin, *America's Role in the World Economy,* Norton, 1945, pp. 22–26.

(109) Auboin, Roger, *Twenty-First Annual Report,* Basle, Switzerland: Bank for International Settlements, June 11, 1951, pp. 250–254.

(110) *International Organizations in which the United States Participates,* Department of State, Government Printing Office, 1949, pp. 60–64.

(111) Condliffe, J. B., "Pounds, Dollars, and Ourselves," *The Survey,* December 1949, pp. 653–657.

95.

THE PERFECT MERCHANT IN 1630

THOMAS MUN

. . . I WILL BRIEFLY SET DOWN the excellent qualities which are required in a perfect Merchant.

1. He ought to be a good Penman, a good Arithmetician, and a good Accomptant, by that noble order of *Debtor* and *Creditor,* which is used onely amongst Merchants; also to be expert in the order and form of Charter-parties, Bills of Lading, Invoyces, Contracts, Bills of Exchange, and Policies of Ensurance.

2. He ought to know the Measures, Weights, and Monies of all forraign Countries, especially where we have Trade, & the Monies not only by their several denominations, but also by their intrinsique values in weight & fineness, compared with the Standard of this Kingdome, without which he cannot well direct his affaires.

3. He ought to know the Customs, Tolls, Taxes, Impositions, Conducts, and other charges upon all manner of Merchandize exported or imported to and from the said forraign Countries.

4. He ought to know in what several commodities each Country abounds, and what be the wares which they want, and how and from whence they are furnished with the same.

5. He ought to understand and to be a diligent observer of the rates of Exchanges by Bills, from one State to another, whereby he may the better direct his affairs, and remit over and receive home his Monies to the most advantage possible.

6. He ought to know what goods are prohibited to be exported or imported in the said forraign Countries, lest otherwise he should incur great danger and loss in the ordering of his affairs.

7. He ought to know upon what rates and conditions to fraight his Ships, and ensure his adventures from one Country to another,

and to be well acquainted with the laws, orders and customes of the Ensurance office both here and beyond the Seas, in the many accidents which may happen upon the damage or loss of Ships or goods, or both these.

8. He ought to have knowledge in the goodness and in the prices of all the several materials which are required for the building and repairing of Ships, and the divers workmanships of the same, as also for the Masts, Tackling, Cordage, Ordnance, Victuals, Munition and Provisions of many kinds; together with the ordinary wages of *Commanders, Officers* and *Mariners,* all which concern the Merchant as he is an Owner of Ships.

9. He ought (by the divers occasions which happen sometime in the buying and selling of one commodity and sometimes in another) to have indifferent if not perfect knowledge in all manner of Merchandize or wares, which is to be as it were a man of all occupations and trades.

10. He ought by his voyaging on the Seas to become skillful in the Art of Navigation.

11. He ought as he is a Traveller, and sometimes abiding in forraign Countries to attain to the speaking of divers Languages, and to be a diligent observer of the ordinary Revenues and expences of forraign Princes, together with their strength both by Sea and Land, their laws, customes, policies, manners, religions, arts, and the like; to be able to give account thereof in all occasions for the good of his Country.

12. Lastly, although there be no necessity that such a Merchant should be a great Scholar; yet is it (at least) required, that in his youth he learn the Latine tongue, which will the better enable him in all the rest of his endeavours.

96 ·

ABSOLUTE ADVANTAGE

ADAM SMITH

THE NATURAL ADVANTAGES which one country has over another in producing particular commodities are sometimes so great that it is acknowledged by all the world to be in vain to struggle with them. By means of glasses, hotbeds, and hot walls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines merely to encourage the making of claret and burgundy in Scotland? But if there would be a manifest absurdity in turning towards any employment thirty times more of the capital and industry of the country than would be necessary to purchase from foreign countries an equal quantity of the commodities wanted, there must be an absurdity, though not altogether so glaring, yet exactly of the same kind, in turning towards any such employment a thirtieth, or even a three-hundredth part more of either. Whether the advantages which one country has over another be natural or acquired is in this respect of no consequence. As long as the one country has those advantages, and the other wants them, it will always be more advantageous for the latter rather to buy of the former than to make it. It is an acquired advantage only, which one artificer has over his neighbour, who exercises another trade; and yet they both find it more advantageous to buy of one another than to make what does not belong to their particular trades.

97 · THE PRINCIPLE OF COMPARATIVE ADVANTAGE

F W. TAUSSIG

WHAT, NOW, ARE THE CAUSES of industrial effectiveness and comparative advantage? To put the question in other words, what are the industries in which a comparative advantage is likely to appear? and, more particularly, in which directions is the labor of the people of the United States likely to be applied with special effectiveness?

The more common answer has been, in agriculture. A new country, with abundance of fertile land, finds its labor most effective in the extractive industries. Hence the United States long were steady exporters of wheat, meat products, cotton. Wheat is specially adapted to extensive culture, and is easily transportable; it is the commodity for which nature gives to a new country in the temperate zone a clear comparative advantage. The international trade of the United States was long determined chiefly by the country's special advantages for the production of wheat and similar agricultural staples.

It should be noted, however, that not only the natural resources told, but the manner in which they were used. From the first, inventiveness and ingenuity were shown. The United States early became the great country of agricultural machinery. Especially during the second half of the nineteenth century, the skill of the makers of agricultural implements and the intelligence of the farmers who used the implements were factors not less important than the great stretches of new land. Still another factor of importance was the cheapening of transportation. From the very beginning, the Americans have been energetic and successful in overcoming the vast distances of their country. Our railroads have cheapened long hauls as nowhere else. The most striking improvements of this sort were made in the last third of the nineteenth century; then new lands were opened, and agricultural products ex-

ported, on a scale not before thought possible. When the effectiveness of labor is spoken of, the effectiveness of *all* the labor needed to bring an article to market is meant; not merely that of the labor immediately and obviously applied (like that of the farmer), but that of the inventor and maker of threshing-machines and gangplows, and that of the manager and worker on the railways and ships. In other industries even more markedly than in agriculture, the labor of the directing heads, of the planners and designers, tells in high degree for the final effectiveness of the labor which is applied through all the successive stages.

That the situation began to change with the opening of the twentieth century does not need to be explained at length. The period of limitless free land was then passed, and with it the possibility of increasing agricultural production under the specially advantageous conditions of new countries. For one great agricultural article—cotton—the comparative advantage of the country indeed maintained itself, and its exports continued to play a great part in international trade. The exports of other agricultural products,—wheat, corn, barley, meat products,—have by no means ceased, nor will they cease for some time. But they tend to decline, absolutely and even more relatively. Other articles grow in importance, such as copper, petroleum, iron and steel products, various manufactures. For some of these,—copper, for example,—the richness of our natural resources is doubtless of controlling importance. But the manner in which those natural resources are turned to account is in all cases important; and in many cases the comparative advantage of which the exports are proof rests not on the favor of nature at all, but solely on the better application of labor under conditions inherently no more promising than those of other countries. What are the causes of advantage under these less simple conditions?

The same question may be asked regarding a closely-allied phenomenon. . . . A considerable range of manufactured articles, though not exported, are yet not imported. The domestic manufacturer holds the domestic market with ease, while paying higher wages than his foreign competitor. The range of such industries is wider than is commonly supposed. It is obscured by the fact that our tariff system imposes needless and inoperative duties on a quantity of things which would not be imported even in the absence of duties. On the other hand there is a considerable range of articles on which the duties do have substantial effect,—articles which would be imported but for the tariff. Some of these continue to be imported notwithstanding high duties; they pour in over the tariff wall. Why the difference between the two sets of cases: those in which the domestic manufacturer holds his own irrespective of

duties, and those in which he needs the duties or even is beaten notwithstanding the tariff support?

The answer commonly given is that American producers can hold their own more easily when much machinery is used. Then, it is said, the wages bill forms a smaller proportion of the expenses of production, and the higher wages of the United States are a less serious obstacle. But it requires no great economic insight to see that this only pushes the question back a step. Why is not the machinery itself more expensive? The machinery was made by labor. It is a commonplace that a commodity made with much use of machinery is the combined product of two sets of laborers,—those who make the instruments and those who operate them. If *all* those whose labor is combined for producing the final result are paid higher wages than in foreign countries, why cannot the foreigners undersell where much machinery is used as well as where little is used?

The real reason why Americans are more likely to hold their own where machinery is much used, and where hand labor plays a comparatively small part in the expenses of production, is that Americans make and use machinery *better*. They turn to labor-saving devices more quickly, and they use devices that save more labor. Where Americans can apply machinery, they do so; and not only do so, but do so better, on the whole, than their foreign competitors. The question remains one of comparative effectiveness. Their machinery is not necessarily cheaper; absolutely often it is dearer; but it is cheap relatively to its effectiveness. It is better machinery, and the labor that operates it turns out in the end a product that costs not more, but less, than the same product costs in countries using no such devices, or using devices not so good.

In general, it may be laid down that this sort of comparative advantage is most likely to appear in the United States in two classes of industries,—those that turn out large quantities of staple homogeneous commodities and those that themselves make tools and machinery. Only where many identical things are turned out, does it pay to construct an elaborate and expensive plant. A machine-using people directs its energies to best advantage where thousands of goods of the same pattern are to be produced. Hence the repeated experience that, notwithstanding high duties, there is a tendency to import specialties and goods salable in small quantities only. Goods used by the masses in large quantities, as distinguished from luxuries bought by the comparatively few who are rich, are likely to be produced at home, without danger of being pushed by competing imports. If specialities, such as goods made to order, *must* be supplied by domestic producers, they are

likely to be what the customer thinks inordinately dear; because they are made preponderantly, or at least in greater degree, by hand labor which is paid high wages and which by the very conditions of the case cannot use labor-saving machinery. Again, implements themselves, big and little, are likely to be well made in a country where people are constantly turning to machinery; from kitchen utensils and household hardware to machine tools, electric apparatus, and huge printing presses. These are things in which the success of American industry is familiar; which are exported, not imported; in which it is proverbial that the Yankee has a peculiar knack,—another way of saying that he has a comparative advantage.

The relation between high wages and the use of machinery calls for a word more of explanation. It is usually said that high wages are a cause of the adoption of machinery, and that we find here the explanation of the greater use of machinery, in the United States. I believe that the relation is the reverse; high wages are the effect, not the cause. To the individual manufacturer it may seem a cause; he schemes to save in the wages bill by adopting a labor-saving device. But the reason why he is induced to scheme is that labor-saving devices are in common use and that the effectiveness of industry at large is therefore great,—hence high wages. No doubt the general situation has its reflex influence on the individual. Every one is put to his trumps; every one feels the need of playing the industrial game at its best. The abundant resources which so long contributed greatly, and indeed still contribute, to making labor productive and wages high, thereby stimulated the introduction of labor-saving methods in industries not so directly affected by the favor of nature. But the fundamental cause of the prevalent use of machinery was in the intelligence and inventiveness of the people; these being promoted again by the breath of freedom and competition in all their affairs. What are the ultimate causes of industrial progress and industrial effectiveness is not easily stated; complex historical, political, perhaps ethnographic forces must be reckoned with. But these causes work out their results in modern times largely by prompting men to improve their implements and to use unhesitatingly new and better implements. Thence flows a high rate of return for their labor; it is not the high rate of return that leads them to use the better tools.

In creating and maintaining the comparative advantage which comes from the better application of the machine processes, the business man —the industrial leader—has become in recent times a more and more important factor. The efficiency of the individual workman has been much dwelt on in discussion of the rivalries of different countries:

aptitude, skill, intelligence, alertness, perhaps inherited traits. No doubt qualities of this sort have counted in the international trade of the United States, and still count. The American mechanic is a handy fellow,—it is from his ranks that the inventors and business leaders have been largely recruited,—and he can run a machine so as to make it work at its best. But there is a steady tendency to make machinery automatic, and largely independent of the skill of the operative who runs it. The mechanics who construct the machines and keep them in repair must indeed be highly skilled. Once, however, the elaborate machine is constructed and kept in perfect running order, the operative simply needs to be assiduous. Under such circumstances the essential basis of a comparative advantage in the machine-using industries is found in management,—in invention, rapid adoption of the best devices, organization.

The business leader has been throughout a person of greater consequence in the United States than elsewhere. He has loomed up large in social consequence because he has been of the first economic consequence. He has constructed the railway, and opened up the country; he has contributed immensely to the utilization of the great agricultural resources; he has led and guided the inventor and mechanic. I am far from being disposed to sing his praises; there are sins enough to be laid to his account. But he has played an enormously effective part in giving American industry its special characteristics. His part is no less decisive now than it was in former times,—nay, more so. The labor conditions brought about by the enormous immigration of recent decades have put at his disposal a vast supply of docile, assiduous, untrained workmen. He has adapted his methods of production to the new situation. His own energy, and the ingenuity and attention of his engineers and inventors and mechanics, have been directed to devising machinery that will almost run itself. Here the newly-arrived immigrant can be used. So far as the American can do this sort of machinery making to peculiar advantage, so far can he pay wages to the immigrants on the higher American scale and yet hold his own against the European competitor who pays lower wages to the immigrant's stay-at-home fellow. But it is on this condition only that he can afford to pay the green hand wages on the American scale, or on some approach to it: he must make the total labor more effective. The main cause of greater effectiveness in the dominating industries is to be found, under the economic conditions of recent times, not so much in the industrial quality of the rank and file as in that of the technical and business leaders.

Similar reasoning is applicable to another cause of effectiveness in

industry which has been much discussed of late,—"scientific management." Some persons believe that here is a panacea of universal application; any and every industry can be made more effective by systematic observation and experiment on each of its steps and management based thereon. With reference to the protective system it was maintained, for example, after the reduction of duties in the tariff act of 1913, that scientific management, if generally adopted, would enable all American industries to meet the new and sharp competition of foreigners. The truth is that here also the question is one of comparative advantage. Scientific management is likely to tell more in some industries than in others. Apparently it tells most in industries of the standardized type,—precisely those in which industrial leadership already has proved of cardinal importance and in which Americans have already shown the greatest aptitude for leadership. It implies large-scale operation; since the heavy expense of preliminary investigation and the enlarged supervisory staff are worth while only if the expense is spread over a large output. It is adapted not to industries which produce specialties or small lots of numerous and varied articles, but to those in which steady repetition of the same operations makes it profitable to work out an elaborate system. The indications are that it will not radically change the character of American manufacturing industry or modify the division between domestic and foreign sources of supply. Rather is it likely to accentuate existing relations; to strengthen American industry where it is already strong. Not all industries equally will feel its influence, but those in which this special form of industrial leadership tells with special effectiveness.

* * * *

We hear frequently of the menace of the cheap labor of China, India, Japan. Will not these countries deluge us with the products of cheap factory labor, when once they have equipped themselves with the latest machinery? The truth is that they will in all probability never thus equip themselves. To do so, would require more than the mere shipment of the machinery and the directions for working it. A completely different industrial environment would need to be transplanted. . . .

None the less, some possibility of this sort does exist, especially in the rivalry between those countries of advanced civilization which are more nearly on the same industrial level. It is by no means out of the question that shoe machinery or automatic looms shall be worked as well in Germany as in the United States. Supposing this to be done, cannot the German employer who gets his operatives at low wages

undersell the American employer who must pay high wages? Is not the comparative advantage which the United States possesses in its ingenious machinery necessarily an elusive one, sure to slip away in time? An advantage may indeed be retained indefinitely where skill or intelligence on the part of the individual workmen are necessary. Even here there is a doubt whether it will persist, in view of the spread of education and technical training the world over. At all events, in the widening range of industries where the workman merely tends semi-automatic machinery, the manufacturing industries of the country having high wages would seem to be in a perilous situation.

The only answer which can be given to questioning of this sort is that the leading country *must retain its lead*. As fast as other countries adopt the known and tried improvements, it must introduce new improvements. Unrelaxed progress is essential to sustained superiority; he who stands still inevitably loses first place.

* * * *

This will seem to the American manufacturer a harsh sentence, and a heartless or unpatriotic one to the ordinary protectionist. What? To be deprived of the fruits of our own enterprise and ingenuity, without protection from a paternal government against the interlopers? Yet I see no other answer consistent with the general reasoning of economics on international trade and the geographical division of labor. The gain which a country secures from its labor is largest when that labor is applied in the most effective way; and labor is applied with the greatest effectiveness only when it proves this effectiveness by sustained ability to hold the field constantly against all rivals.

98 ·

TARIFF NULLIFICATION, 1832

WHEREAS THE CONGRESS OF THE UNITED STATES, by various acts, purporting to be acts laying duties and imposts on foreign imports, but in reality intended for the protection of domestic manufactures, and the giving of bounties to classes and individuals engaged in particular employments, at the expense and to the injury and oppression of other classes and individuals, and by wholly exempting from taxation certain foreign commodities, such as are not produced or manufactured in the United States, to afford a pretext for imposing higher and excessive duties on articles similar to those intended to be protected, hath exceeded its just powers under the Constitution, which confers on it no authority to afford such protection, and hath violated the true meaning and intent of the Constitution, which provides for equality in imposing the burthens of taxation upon the several states and portions of the confederacy: And whereas the said Congress, exceeding its just power to impose taxes and collect revenue for the purpose of effecting and accomplishing the specific objects and purposes which the Constitution of the United States authorizes it to effect and accomplish, hath raised and collected unnecessary revenue for objects unauthorized by the Constitution:

We, therefore, the people of the State of South Carolina in Convention assembled, do declare and ordain, and it is hereby declared and ordained, that the several acts and parts of acts of the Congress of the United States, purporting to be laws for the imposing of duties and imposts on the importation of foreign commodities, and now having actual operation and effect within the United states, and, more especially, an act entitled "An act in alteration of the several acts imposing duties on imports," approved on the nineteenth day of May, one thousand eight hundred and thirty-two, are unauthorized by the Con-

stitution of the United States, and violate the true meaning and intent thereof, and are null, void, and no law, nor binding upon this State, its officers or citizens; and all promises, contracts, and obligations, made or entered into, or to be made or entered into, with purpose to secure the duties imposed by the said acts, and all judicial proceedings which shall be hereafter had in affirmance thereof, are and shall be held utterly null and void.

And it is further ordained, that it shall not be lawful for any of the constituted authorities, whether of this State or of the United States, to enforce the payment of duties imposed by the said acts within the limits of this State; but it shall be the duty of the Legislature to adopt such measures and pass such acts as may be necessary to give full effect to this ordinance, and to prevent the enforcement and arrest the operation of the said acts and parts of acts of the Congress of the United States within the limits of this State, from and after the first day of February next, and the duty of all other constituted authorities, and of all persons residing or being within the limits of this State, and they are hereby required and enjoined, to obey and give effect to this ordinance, and such acts and measures of the Legislature as may be passed or adopted in obedience thereto.

And it is further ordained, that in no case of law or equity, decided in the courts of this State, wherein shall be drawn in question the authority of this ordinance, or the validity of such act or acts of the Legislature as may be passed for the purpose of giving effect thereto, or the validity of the aforesaid acts of Congress, imposing duties, shall any appeal be taken or allowed to the Supreme Court of the United States, nor shall any copy of the record be permitted or allowed for that purpose; and if any such appeal shall be attempted to be taken, the courts of this State shall proceed to execute and enforce their judgements, according to the laws and usages of the State, without reference to such attempted appeal, and the person or persons attempting to take such appeal may be dealt with as for a contempt of the court.

And it is further ordained, that all persons now holding any office of honor, profit, or trust, civil or military, under this State, (members of the Legislature excepted,) shall, within such time, and in such manner as the Legislature shall prescribe, take an oath well and truly to obey, execute, and enforce this ordinance, and such act or acts of the Legislature as may be passed in pursuance thereof, according to the true intent and meaning of the same; and on the neglect or omission of any such person or persons so to do, his or their office or offices shall be forthwith vacated, and shall be filled up as if such person or persons

were dead or had resigned; and no person hereafter elected to any office of honor, profit, or trust, civil or military, (members of the Legislature excepted,) shall, until the Legislature shall otherwise provide and direct, enter on the execution of his office, or be in any respect competent to discharge the duties thereof, until he shall, in like manner, have taken a similar oath; and no juror shall be empanneled in any of the courts of this State, in any cause in which shall be in question this ordinance, or any act of the Legislature passed in pursuance thereof, unless he shall first, in addition to the usual oath, have taken an oath that he will well and truly obey, execute, and enforce this ordinance, and such act or acts of the Legislature as may be passed to carry the same into operation and effect, according to the true intent and meaning thereof.

And we, the people of South Carolina, to the end that it may be fully understood by the Government of the United States, and the people of the co-States, that we are determined to maintain this, our ordinance and declaration, at every hazard, do further declare that we will not submit to the application of force, on the part of the Federal Government, to reduce this State to obedience; but that we will consider the passage, by Congress, of any act authorizing the employment of a military or naval force against the State of South Carolina, her constituted authorities or citizens; or any act abolishing or closing the ports of this State, or any of them, or otherwise obstructing the free ingress and egress of vessels to and from the said ports, or any other act on the part of the Federal Government, to coerce the State, shut up her ports, destroy or harass her commerce, or to enforce the acts hereby declared null and void, otherwise than through the civil tribunals of the country, as inconsistent with the longer continuance of South Carolina in the Union: and that the people of this State will thenceforth hold themselves absolved from all further obligation to maintain or preserve their political connexion with the people of the other States, and will forthwith proceed to organize a separate Government, and do all other acts and things which sovereign and independent States may of right do.

99 ·

PROTEST OF 1,028 AMERICAN ECONOMISTS TO PRESIDENT HOOVER, MAY 5, 1930

THE UNDERSIGNED AMERICAN ECONOMISTS and teachers of economics strongly urge that any measure which provides for a general upward revision of tariff rates be denied passage by Congress, or if passed, be vetoed by the President.

We are convinced that increased restrictive duties would be a mistake. They would operate, in general, to increase the prices which domestic consumers would have to pay. By raising prices they would encourage concerns with higher costs to undertake production, thus compelling the consumer to subsidize waste and inefficiency in industry.

At the same time they would force him to pay higher rates of profit to established firms which enjoyed lower production costs. A higher level of duties, such as is contemplated by the Smoot-Hawley bill, would therefore raise the cost of living and injure the great majority of our citizens.

Few people could hope to gain from such a change. Miners, construction, transportation, and public utility workers, professional people and those employed in banks, hotels, newspaper offices, in the wholesale and retail trades and scores of other occupations would clearly lose, since they produce no products which could be specially favored by tariff barriers.

The vast majority of farmers would also lose. Their cotton, pork, lard and wheat are export crops and are sold in the world market. They have no important competition in the home market. They cannot

benefit, therefore, from any tariff which is imposed upon the basic commodities which they produce.

They would lose through the increased duties on manufactured goods, however, and in a double fashion. First, as consumers they would have to pay still higher prices for the products, made of textiles, chemicals, iron and steel, which they buy. Second, as producers their ability to sell their products would be further restricted by the barriers placed in the way of foreigners who wished to sell manufactured goods to us.

Our export trade, in general, would suffer. Countries cannot permanently buy from us unless they are permitted to sell to us, and the more we restrict the importation of goods from them by means of higher tariffs, the more we reduce the possibility of our exporting to them.

This applies to such exporting industries as copper, automobiles, agricultural machinery, typewriters and the like fully as much as it does to farming. The difficulties of these industries are likely to be increased still further if we pass a higher tariff.

There are already many evidences that such action would inevitably provoke other countries to pay us back in kind by levying retaliatory duties against our goods. . . .

We do not believe that American manufacturers, in general, need higher tariffs. The report of the President's Committee on Recent Economic Changes has shown that industrial efficiency has increased, that costs have fallen, that profits have grown with amazing rapidity since the end of the World War. Already our factories supply our people with over 96% of the manufactured goods which they consume, and our producers look to foreign markets to absorb the increasing output of their machines.

Further barriers to trade will serve them not well, but ill.

Many of our citizens have invested their money in foreign enterprises. The Department of Commerce has estimated that such investments, entirely aside from the war debts, amounted to between \$12,555,000,000 and \$14,555,000,000 on January 1, 1929. These investors, too, would suffer if restrictive duties were to be increased, since such action would make it still more difficult for their foreign debtors to pay them the interest due them.

America is now facing the problem of unemployment. The proponents of higher tariffs claim that an increase in rates will give work to the idle. This is not true. We cannot increase employment by restrictive trade. . . .

Finally, we would urge our government to consider the bitterness

which a policy of higher tariffs would inevitably inject into our international relations.

A tariff war does not furnish good soil for the growth of world peace.

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THE AMERICAN TARIFF OF 1930

AN ADVERTISEMENT published by the Swiss Watch Industry in the *Gazette de Lausanne,* May 2, 1930:

The American Tariff project envisages an average increase in the duties on watch products of 300 PER CENT WITHOUT JUSTIFICATION. Such a project constitutes an unfriendly act toward Switzerland; it COMPROMISES a part of its NATIONAL ECONOMY. In order to react against a danger which menaces us, and in a spirit of solidarity, we ask all the INDUSTRIALS, ARTISANS, MERCHANTS, AND CONSUMERS to ban from their OFFICES, FACTORIES, WORKSHOPS, GARAGES, STORES, and HOMES all merchandise coming from the United States.

An advertisement in all Basle, Switzerland, newspapers, May 6, 1930:

Let us defend ourselves against the exaggerated pretensions of America whose new customs tariff constitutes a DECLARATION OF WAR against European products. DO NOT BE FOOLISH ENOUGH TO CONTINUE TO SUPPORT AMERICAN INDUSTRIES BY PURCHASING THEIR PRODUCTS. Motorists, by giving preference to vehicles constructed on the Continent you will benefit indirectly the prosperity of European industries. Only European makes

have really been conceived and constructed for your country. IN THE INTEREST OF YOUR COUNTRY—IN YOUR INTEREST—before deciding upon the purchase of a car, try the three great makes—Voisin—Hotchkiss—Delaunay, whose perfection in all qualities has been carried to the highest degree.

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THE "TEN PER CENT" FALLACY

AMOS E. TAYLOR

One of the most persistent misconceptions concerning the importance of foreign trade to the national economy arises from the so-called "ten per cent" fallacy. The underlying contention is simple and appealing because it is usually expressed in simple arithmetical terms. Advanced particularly with reference to exports the argument holds that since the United States sells only a small fraction—rarely more than ten per cent—of its domestic output in foreign markets the development and promotion of exports is not worth the effort. It is maintained that, since the amount exported is negligible when compared with the ninety or more per cent consumed at home, exports provide the national economy with no worthwhile net advantages. Similarly, it is pointed out that the annual imports into the United States are very small in value and volume if compared with total annual consumption.

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In the field of foreign trade various misconceptions still influence popular thought. Some of these relate to the nature of foreign trade and the consequences of doing business with foreign customers. Views are often based on a psychological dislike of the label "foreign." Imports are often looked upon as objectionable merely because they involve

purchases of goods which we could perhaps produce at home. Sometimes purchases of foreign goods are viewed as objectionable on the theory that payments made for such goods make it necessary to "send money out of the country," and that, therefore, the country becomes correspondingly poorer. In most of these cases the underlying argument stems not only from a failure to understand the nature and functions of money but also from a misconception as to the nature of business conducted across national frontiers.

Various objections are raised to the expansion of exports. It is argued, for example, that a rise in exports can make no real contribution to employment except to the extent that such a rise widens the excess of exports over imports. The contention is frequently made that the United States export markets are adversely affected whenever other countries increase their sales in such markets. . . . Such a view of foreign trade is closely linked with the idea that international commerce is by its very nature a form of economic warfare. . . .

The tendency to depreciate the importance of foreign trade in the United States economy thus arises from a number of misconceptions, which often reflect a lag between fundamental changes in the structure of the world economy and the policy implementation dictated by the nature and timing of these changes. . . .

We are on the threshold of important decisions in the realm of international economic cooperation. The shrinkage of time and space has made the United States more and more a part of a single world community. . . .

During the first decade following the First World War the ratio of exports of United States merchandise to the total output of movable goods averaged approximately ten per cent. With the decline in business generally during the 'thirties this ratio fell to an annual average of roughly seven per cent. A rise in this ratio has invariably been identified with an improvement in business conditions and a rise in employment, whereas a fall has always reflected a trend in the reverse direction. It would appear, therefore, that instead of viewing the relatively small percentage of total output entering export trade with indifference our efforts should be directed towards the achievement of a higher and self-sustaining export trade.

The real significance of exports to our domestic economy lies primarily in (1) the commodity distribution showing the relative importance of particular commodities in relation to their total output, and (2) the indirect effects of particular commodity exports upon the economy of areas and industries not directly participating to any substantial degree in the export trade.

Although only from seven to ten per cent of total output is normally exported, these percentages are heavily weighted by the key products of particular areas and by substantial proportions of the total output of certain types of enterprise. Exports of raw cotton normally range from approximately thirty to more than sixty per cent of total production. Cotton is the principal crop of the South but its production extends into sections of the Southwest. It is grown on about one-fourth of the nation's farms and more than forty per cent of the total farm population is found in the states in which cotton production is centered. The consequences of eliminating the cotton farmers and the many thousands of persons engaged in picking, ginning, compressing, warehousing, and transporting cotton would be serious not only in the states immediately concerned but also to the rest of the country. Cotton is a source of purchasing power which provides a stimulus to industry and business throughout the country. Factory employment in the non-cotton states is heavily supported by cotton exports which averaged more than half a billion dollars a year during the interwar years.

Cotton is not the only commodity which relies heavily on export markets. . . .

Exports moving through southern ports during the interwar years comprised about thirty per cent of total United States exports. . . .

The products of the South are, however, not the only commodities whose producers look to foreign markets for the sale of a substantial part of their output. Thirty per cent or more of the production of such commodities as canned sardines, dried prunes, lubricating oil, paraffin wax, refined copper, and sewing machines enters the export market. . . .

Agriculture and industry both gain from export markets. The direct advantages accruing to one pass on to the other. . . .

In many cases the final ten per cent can make all the difference between profit and loss for a particular enterprise. Moreover, the equipment necessary for producing the portion exported is not something set apart from that necessary for producing the remaining ninety per cent. . . .

The attempt to minimize the importance of United States exports to the maintenance of domestic prosperity frequently stems from the alleged negligible contribution which such exports make to total employment in the United States. This issue has become confused as a result of a tendency, all too common, to view export markets merely as a residual outlet for additional goods whenever the inadequacy of the domestic market prompts producers to seek more buyers abroad. This view distorts the real nature of the problem since it implies that the expansion of exports as a means of increasing domestic employment

may be viewed as an end in itself. Such an approach to the problem fails to recognize the interdependence of domestic and foreign markets. An examination of the real nature of the relationship between exports and employment leads to more or less fruitless results unless we consider the functional character of United States exports in the broad stream of world commerce.

The real significance of exports as a factor in domestic employment does not lie in strictly arithmetical measurements. . . .

Estimates which have been made relative to the number of persons engaged in the production and servicing of goods for export do not include any corrections covering changes in trade on the size and distribution of the national income or on the production levels of various industries. Moreover, such estimates could not take proper note of the fact that if exports were entirely cut off the productivity of labor or the average hours of employment would not necessarily remain the same. . . .

Foreign trade cannot be viewed as an end in itself. It is part of a process in which the effect of all interrelated elements is much more important than absolute statistical measurement. . . .

The employment provided by export markets is no less important to full employment than the exports themselves are to a sound domestic economy. The advantages of a rise in both are obvious but they cannot be safely sought as ends in themselves. It is in the national interest to have both rise rather than fall but measures designed to expand exports and employment must be consistent with a much broader policy which aims at a maximum level of production, national income, employment, domestic trade, and foreign trade. If the farm and industrial workers directly employed because of our export trade were eliminated the net effect on total employment would be much greater than the bare statistical reduction would suggest. . . .

United States exports have a far-reaching effect on the domestic economy. Payments made for exported industrial products do more than maintain employment in the manufacturing industries. These immediate benefits pass on to the farms and to the mines and they stimulate activity in transport, banking, and insurance. . . .

* * * *

The "ten per cent" fallacy would attack the very basis upon which the economic structure for the future peace of the world must rest. Those who oppose a program of international economic cooperation looking toward an expanded export-import trade often complain that too much time and consideration are devoted to what they maintain is

a negligible factor in our economy. Contrary to the theories of autarky and self-containment the fact is that the domestic prosperity of every economically advanced country is tied in with the conditions of its foreign trade. In the United States, as in other countries, the ill effects of the collapse of export outlets during the early 'thirties for the great surplus-producing branches of both agriculture and industry rapidly permeated all branches of our economic life.

* * * *

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OUR FOREIGN POLICY

THERE IS NO LONGER any real distinction between "domestic" and "foreign" affairs.

Practically everything we do, the way we tax and spend our national income, the way we run our public and private business, the way we settle the differences among ourselves and with other nations, what we say in our newspapers, over the air and on public platforms, our attitudes toward each other and toward other peoples—all these things affect not only our security and well-being at home, but also our influence abroad.

All these things go into the making of the character, the personality and the reputation of the United States. Out of all these things grow the foreign policies of the United States.

Policies are an expression of the national interests.

That is a way of saying that our policies reflect what we are and what we want.

During the 175 years since we became a nation, our national inter-

ests have changed in some ways, but their general character has remained constant. Here are some of the values that have persisted all through our history:

We are an independent nation and we want to keep our independence.

We attach the highest importance to individual freedom, and we mean to keep our freedom.

We are a peaceful people, and we want to get rid of wars and the threat of wars.

We have a comparatively high standard of living. We want to raise the standard so that everyone in the United States will eventually have a chance to earn a decent and secure living.

We are a friendly people. We have no traditional "enemies," and we want to be on good terms with every other people.

These are the things on which Americans, with all their different points of view, are most likely to agree.

It is the job of the Government, as the agent of the people, to promote these national interests.

The Federal Government, as the agent of the people, continually has hard choices to make. It is the job of the Government, as the agent of all the people, to try to harmonize group and sectional interests on the one hand with national interests on the other.

There has never been a time in our history when we could go about the business of promoting our national interests free from the threat of destructive forces. Some of these forces are inside the country. They stem from groups that oppose the national interests. Some Americans have a view of life that conflicts with the basic propositions on which our democracy was founded. Some try to profit at the expense of the freedom or well-being of others.

Some hostile forces have been outside our country. They have come from nations or ruling groups bent on waging military or economic war or on dominating other nations.

To deal with these forces, the American people have had to subordinate some of their national interests temporarily, in order to promote or preserve others. For example, three times in recent years we have been forced to disrupt our peaceful lives and take up arms to preserve the independence and freedom that we value even more highly. When there is a threat of aggression, our vital interest in peace forces us to tax ourselves heavily to build the military and economic defenses of the free world, at the expense of our interest in a rising standard of living.

So it is that making policy is a matter of making choices. Often

it is a matter of making hard and unpleasant choices, of deciding which is the lesser of two evils.

Sometimes it is possible to make policies that are creative and good in themselves, because they make a bold new approach to a tough old problem, or because they foresee a need before it arises, or because they head off trouble before it starts.

Recent history provides examples of such policies in lend-lease, the United Nations, the Marshall Plan, and the Point Four Program.

Politics has been described as the art of the possible. To broaden the area of the possible is the art of statesmanship.

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POINT FOUR

HENRY HAZLITT

LET US BEGIN by summarizing the principal objections we have found to Point Four:

1. The fact that it so strikingly resembles the proposals of the official head of the Communists in this country in 1944 is strong ground for initial suspicion. It would be strange to embrace the program of our enemy in an expensive "cold war" designed to stop the spread of that program.

2. Point Four will not add to the total invested capital of the world. It will at best merely *divert* that capital from one channel to another.

3. It will tend to divert capital from the development of private enterprises to the development of statist, militarist or socialistic enterprises.

4. We cannot give our cake away and eat it too. We can speed up the capital development of other countries only at the expense of our

own capital development. We cannot get rich by giving our exports away.

5. The British peanut fiasco illustrates in advance what a typical Point Four project would be like.

6. Even those who believe that a Point Four program is necessary should recall that the International Bank for Reconstruction and Development, and the Export-Import Bank, already exist to do precisely what is proposed under Point Four and are already doing it in ample volume.

7. Though Point Four professes to be a plan for extending repayable loans, it would in fact quickly become a plan for making disguised gifts.

8. The proposed government guarantees of private capital invested abroad mean that we would allow private investors to keep the profits of their investment but would force the American taxpayers to assume the losses. Such an arrangement would be intolerable. It could only lead to the control and eventual nationalization of all foreign investment.

9. Point Four would not in the least reduce the risks of foreign investment, but merely transfer them from the American investor to the American taxpayers.

10. The assumption that government lending (or sponsorship) could do more to reduce the risks of foreign investment than private lending is the reverse of the truth.

11. If conditions abroad were such today as to encourage American investors to lend abroad the same proportion of total national income as British private investors did in the late Nineteenth Century, our private foreign investments would reach about $5,000,000,000 a year.

12. Once we accept the principle that we owe the rest of the world a living, our responsibilities become endless and bottomless.

These objections to a wrong course indicate clearly what the right course must be. The real barrier to international loans today is not lack of potential private American investment funds but lack of proper assurances for their safety from the governments of the foreign countries that wish to borrow. The real initiative, therefore, must come from these governments. The first reforms must come from within each country that wishes to accelerate its capital development by loans from abroad. Each would-be borrowing country must make itself credit-worthy. It must inspire or regain the confidence of the private foreign investor.

It can do this only by adopting or restoring a truly liberal economic

policy. It must abandon price control, profit control and wage control, and restore a vigorous, free, competitive market economy. It must dismantle exchange control, and the whole system that goes with it—prohibitions, licensing, quotas, bilateralism, multiple exchange rates, and dual-pricing. It must permit its currency to be at all times freely convertible in any amount into all other currencies, including the dollar, at whatever rates are established in a free market. It must reduce its government expenditures and taxes to levels that do not strangle incentive, initiative and production. It must balance its budget, annually and continuously. It must abandon cheap money policies, which can only be kept going by inflation. It must stop inflating money and credit. It must restore confidence in the value of its currency unit. This means, in my opinion, that it must work its way back to a gold standard, and cooperate with other nations in the restoration of a full international gold standard. The international gold standard was the greatest adventure in international "integration" that the world has ever seen.

This does not mean that there are no steps for our own government to take. It, too, must reduce expenditures and taxes to levels that encourage incentive, initiative, and maximum production. If it wishes to leave businesses and individuals potential funds to invest abroad, it must stop taking most of those funds away in taxes. It, too, must abandon its inflationary cheap-money policies. It must above all protect the integrity of the dollar. It must take the initiative in restoring a full gold standard.

If it continues to extend Marshall Plan aid, it must at least make such aid conditional on the return of the recipient governments to genuinely liberal policies that will permit recovery, convertibility of currencies, free multilateral trade, and full production.

Though tariffs are today a far less serious barrier to international trade than quotas, bilateral treaties, price control and exchange control, we should of course continue to reduce or eliminate protective duties, so that foreign nations can sell us more goods in repayment for their borrowings. We should protect only industries indisputably essential for defense, and only if their existence cannot be assured in any better way.

But the major reforms must come from the countries that wish to attract the foreign investment. "We are told," wrote William Graham Sumner in 1889, "what fine things would happen if every one of us would go and do something for the welfare of somebody else; but why not contemplate also the immense gain which would ensue if everybody would do something for himself?"

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THE PROMISE OF POINT FOUR

MAN HAS ONLY BEGUN TO SCRATCH the surface of the earth's wealth. In great areas of Africa, Asia, and Latin America, millions of people are living in poverty because they have not had a chance to apply modern methods of tilling their soil, mining their minerals, and processing the resources they have at hand. The burden of poverty, disease, and ignorance in these areas has become a danger to all free, democratic people, because it invites all kinds of totalitarian controls, including communism.

For many generations, Americans have gone out to work with the people of the underdeveloped parts of the world to study their ways of life, and to share American skills and knowledge with them. American private capital has gone out, also, to finance the development of oil, rubber, tin, bauxite, and many other resources of these areas. For the past 10 years the United States Government has been authorized by Congress to send technical missions abroad, chiefly to Latin America, and to bring technicians from the less developed countries to the United States for training.

In his inaugural address of January 1949, President Truman proposed to raise these traditional American activities and interests to the level of a major national policy and a major enterprise of the American people and their Government. Because this proposal was the fourth point of the President's declaration of foreign policy, it has become known as Point Four.

"We must embark," said Mr. Truman, "on a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas.... We should make available to peace-loving peoples the benefits of our

store of technical knowledge in order to help them realize their aspirations for a better life. And, in cooperation with other free nations, we should foster capital investment in areas needing development. . . .

"Our aim should be to help the free peoples of the world, through their own efforts, to produce more food, more clothing, more materials for housing, and more mechanical power to lighten their burdens."

The Point Four undertaking, as the President conceived it, has two distinct, but closely related, elements. One is "technical cooperation," which means the use of skills and scientific knowledge to help people raise their standards of living. This part of the program costs relatively small amounts of money for the salaries of technicians and the equipment they use.

The other element is large-scale development, requiring sizable amounts of money in the form of investment capital. The underdeveloped areas themselves can supply some, but not all, of the necessary capital. Foreign capital is needed, and it can come from three sources: the International Bank for Reconstruction and Development, the Export-Import Bank of the United States, and from private banks and investors.

Because of uncertainties and tensions in the world, and because of conditions in the underdeveloped areas, private investors have not been eager to risk sending their capital abroad in large amounts. The United States Government is trying in various ways to reduce some of the risks.

For example, the State Department is negotiating new treaties with foreign governments, guaranteeing certain kinds of protection to American investors, so that they will not be discriminated against but will receive the same treatment as nationals of the country. New laws are being considered which would allow the Export-Import Bank to sell an investor certain kinds of insurance specifically against expropriation, confiscation, and seizure, and against inability to convert local currencies—meaning inability to take profits out of the country.

But even with this kind of protection, it is not likely that large amounts of private investment capital will flow to the underdeveloped areas in the near future.

Fortunately, the work of technical cooperation can go forward without delay, and it can, in fact, help to create the kind of world climate and, more particularly, the kinds of local conditions which encourage investment. For experience shows that certain basic services like public health, sanitation, literacy, good communications, and good public administration are usually the necessary forerunners of large-scale develop-

ment projects. These are among the services that the technical cooperation program helps to create or improve.

Congress put its approval on the program in April 1950 and gave the State Department the job of directing the work of technical cooperation. Many agencies of the Government and many private organizations are already carrying on this kind of work.

Under the new program, the work will be broader and more closely coordinated, so that it can become in time a major national effort.

For the first year's budget, the Congress appropriated 34.5 million dollars. Roughly a third of this budget is pledged to the support of a United Nations technical cooperation program.

Americans have never claimed a monopoly of technical skills. Our experts are, in fact, quick to recognize the pre-eminence of other nations in certain fields; for example, the Norwegians in the science of fishery, the British in some aspects of tropical medicine. The specialized agencies of the United Nations, such as the Food and Agriculture Organization and the World Health Organization, are in a position to draw on the skills of many nations—as well as their financial support. At a special meeting of the United Nations in June 1950, 50 nations pledged 20 million dollars for the first year of the United Nations program. Some of the pledges came from nations on the receiving end of technical aid.

Technical cooperation is not something to which you can apply a set of rules. But certain basic principles can and should guide the work. One of these is the principle of self-help. The United States offers its skills only where they are plainly wanted and only where people have shown that they are ready to help themselves. When this readiness exists—and it usually involves breaking with old habits and traditions—then technical cooperation brings good, and often quick, results.

Another guiding principle of this work is to start where people are; to help them solve their own problems in their own way, and not to impose ideas or methods which are alien to their character and their own desires.

Americans have always been interested in dealing with other people, as people, not as pawns in some international game of power politics. All through the history of our international relations runs the thread of a consistent attitude and purpose: to work with others, to cooperate but not to dominate. This is the paramount principle which guides the Point Four program.

The character of the program has sometimes been misunderstood. It has been called a "big money" program, a means of scattering dollars

around the world. Obviously it is not that, but a means of spreading ideas and skills. It has been called a "welfare" program. Obviously, it is that—in the best sense of the word.

Some people have asked, "Why should we help the people of these 'underdeveloped' areas to raise their standard of living when we have plenty of Americans who need that kind of help?" The answer, of course, is that we can do both, and we are, in fact, doing both. Many Point Four projects are patterned on, for example, the work we are doing right here at home in soil conservation, irrigation, and public health. All such programs, both at home and abroad, enlarge our experience and our knowledge. The exchange in ideas and skills is a two-way traffic.

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POINT FOUR PROGRAM IN LIBERIA

The Point Four idea is based on solid experience and a practical demonstration of what can be accomplished by technical cooperation.

Almost 10 years ago, work began in the little Republic of Liberia on the west coast of Africa, which we now recognize as a pilot project for the Point Four Program. Until recently most Americans knew little about Liberia. They may have learned from their history books that it had been colonized by Negro freedmen from the United States. Since then the ties between the two countries have become strong.

When the African settlement declared itself an independent nation in 1847, it adopted a constitution and a governmental structure modeled closely after our own. The official language is English though most of

the tribal people speak their own dialects. In 1943 the legislature sanctioned the use of the United States dollar as Libera's currency.

During World War II thousands of Americans passed through Liberia on the way to North Africa or the Middle East. A few hundred took part in building or guarding the airfield and the free port of Monrovia. They and some of their fellow citizens back in the United States began to understand the importance of Liberia in the family of democratic nations. The African country that lies closest to the shores of Brazil, Liberia is a necessary link in air communications between the United States, Africa, and the Near East. Two of Liberia's crops, rubber and red palm oil, are "strategic" materials. During 1943, when our sources of rubber in the Far East had been almost entirely cut off, we received 31,000 tons of rubber—half of our supply—from Liberia. Other products that are important are iron, lumber, cocoa, and coffee.

After seeing some of the work of American technicians, the Government of Liberia asked cooperation in developing its country. A United States Health Mission and a United States Economic Mission arrived in the country in 1944. It was the Economic Mission that brought Frank Pinder to the country and set him on the first of his many expeditions to villages and tribes deep in the jungle.

When Pinder came to Liberia he observed that the country did not grow enough food for its population of around a million people. He knew that most of them did not have enough to eat to keep them healthy. He found out that there was a "hungry season" during which starvation came very close to many people. He went out with the full support and cooperation of the Government of Liberia which had long been concerned about the food problem. To deal with the hard facts, he had a sack of seed corn and a few simple farming tools.

This was not Pinder's first experience in helping people to help themselves. Born some 40 years before in Key West, Florida, at a time when most boys in that town grew up to wring a precarious living from the sea, Pinder turned to the soil. After graduating from the Florida Agricultural School for Negroes, he went to work with the poor share croppers in the Everglades.

For a time he taught agricultural subjects at Tuskegee Institute. Then he served as an economist in the Farm Security Administration. Early in World War II, when violence flared up between the Jamaicans brought to this country as emergency laborers and their American employers, he had been called to arbitrate the differences between them.

As Pinder went about his work in Liberia, there was none of the

fanfare usually associated with a visiting diplomat. Liberia had no beasts of burden. Human headloading is the method of carrying supplies. Pinder did not then, and never has, ridden in a hammock slung between four bearers. Instead, a sturdy man of medium height, he walked along a narrow trail worn through the jungle by generations of native citizens.

As he walked along, clad in a ragged white shirt, khaki pants, and heavy work shoes, he puffed away at his pipe, observing the soil, the plants, the trees. He was intensely interested in every aspect of this countryside which he would do a great deal to change in certain localities. As he went, his soft voice and friendly smile made him more welcome than any official trappings could have done.

Wartime shortages made it impossible to get any of the supplies that Pinder needed for a trek through a tropical country. He did not wait for supplies. He lived on the land as he went along, and he lived with the people, learning to fit himself into the customs of the country. He learned to know the peoples' problems and their needs at first hand.

When he came to a village, he went immediately to the palavar house—which was also the guest house—and presented himself to the village chief. Toward sundown, when the day's work was over, the chief would summon the village elders and long talks followed. These talks might be continued on the several nights of Pinder's visit. He found it necessary to listen sympathetically to accounts of a variety of troubles such as boundary disputes, domestic squabbles, and tales of hunting prowess. He managed, always, to turn the conversation back to crops, seeds, plants, seasons, and methods of cultivation. This was not too difficult because everywhere the people lived on a day-to-day basis and the threat of hunger was constantly with them.

What Pinder found in the country back of the coastal strip pointed to the need for some drastic changes in methods of farming. The Liberian custom of moving on to a new clearing each year, allowing the cultivated land of the previous year to go back to bush, was wasteful of manpower and land. There was very little protein food—meat, fish, eggs—in the diet of the people. Fresh vegetables were always scarce and practically nonexistent in the dry season.

Rice and cassava were the principal foods. Often, they were the only foods. A little corn was grown in a haphazard manner among the other crops. Rice was planted in the uplands in the rainy season between April and November, but not enough was grown to carry through the dry months. Hence, the "hungry season."

Talking with the village chiefs and elders, Pinder pointed out to them that if they would clear the inland swamps a crop of rice could

be grown which would carry them through the dry months. They protested that it was impossible to clear those swamps. The growth was too dense. Men were not strong enough to do it. Besides, it had never been done. Patiently Frank Pinder assured them over and over again that it could be done. He would show them how with the help of the steel tools he had brought along.

Finally one village decided to try it. Once the decision was made, even the grumblers came along since they had had their say in the palavar house, very much in the manner of a New England Town Meeting. The American, as he had promised, helped in the strenuous task of clearing the bush. Afterward he kept in close touch with the village, offering suggestions about the planting and rejoicing when signs of sprouting began.

At the time of the harvest, Pinder saw to it that a meeting of chiefs and elders from nearby villages was called so that they could see with their own eyes the miracle of a rice crop in the dry season. The demonstration was more persuasive than a dozen arguments to communities which already had begun to tighten their belts. In the next dry season, other "hungry farms," as they are called, began to appear in the swamps.

The Liberians took other steps toward helping themselves. They followed Pinder's instructions about planting hybrid corn, giving it the special attention it needed. In some places they experimented with open ditch irrigation to grow vegetables in the dry season, using seeds given them by the American. Frank Pinder never went out on an expedition without seeds. He was both an itinerant preacher of agriculture and a Johnny Appleseed of Liberia. Now, cabbage which used to sell for a cent a leaf costs only a few cents a pound; a small onion which used to be worth five cents sells for about the same price as it would in the United States.

Tales of the improvements in crops, trees, poultry were carried to the tribal chiefs. When Pinder called at the palavar house of one of these important personages, he found the chief and his council were interested and would take suggestions. Since the word of such a chief was law all down the line, the area grew where people not only were raising more and better food for themselves but also had some left over to sell.

These first important steps were not without their cost. In 7 years of making what the Liberians call "patrols," Pinder suffered attacks of malaria, dysentery, and other tropical ills—often when he was in the interior far from medical help.

One of the first plans mapped out in the early days of the Economic

Mission was the training of Liberians in modern methods of farming. Sixty trained Liberians have been sent out to the more important farming areas to teach the use of improved seed, new farming methods, and the use and care of farm equipment. Pinder has one United States assistant and a rotating staff of about ten Liberian technicians. He trains and then releases them to work in the Liberian Department of Agriculture and Commerce.

Pinder had a great deal to do with the modernizing of this department. When the Economic Mission came to Liberia, the Government's Bureau of Agriculture had a staff of one or two and a token appropriation of a few hundred dollars a year. Within a year, it had been enlarged and granted more funds. In 1948, the Liberian Government created a Department of Agriculture and Commerce of full cabinet level, with a budget of $100,000 a year. In 1949, the Liberian Government paid for the whole training program, which has been continued and expanded with the aid and advice of a U. S. mission.

When Pinder first started making his expeditions into the countryside, living with the people and making note of what was lacking in their diet, he was struck by the small, scrawny chickens which laid eggs not much larger than robins' eggs. At his recommendation, the Economic Mission and the Department of Agriculture imported from the United States several hundred large roosters of the best strains. Two hundred of these were allotted to the Booker T. Washington Institute and the rest were kept at one of the Mission's experimental stations.

Reports of big, healthy chickens and the size of the eggs they laid spread through the countryside. People traveled long distances on foot or by canoe to see them. A few of the new chicks were given to native farmers. They agreed to feed them strictly according to the rules laid down by Mission personnel and later to distribute their offspring to neighbors. Those farmers lucky enough to be assigned the chicks have treated their good fortune as a solemn trust and are helping with their distribution. Large, fresh eggs are doing wonders in raising the Liberian standard of eating and living.

The national income of Liberia comes mainly from rubber growing, which belongs mostly to a private concession, and from the sale of palm oil, palm kernels, and cocoa. Red palm oil is important in the processing of tin plate. All of it used to be obtained from wild oil palms. The oil was extracted by the simplest of hand methods. Pinder brought in a better strain of palms from Nigeria. These have been successfully raised on the experimental farms of the Government and the Mission.

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THE URGE TO INDUSTRIALIZATION

PERCY W. BIDWELL

IN COUNTRIES which are still undeveloped industrially, e.g., China, India, and the Latin American republics, the demand for a better life takes a different shape. By stimulating manufacturing and mining in these areas, the war has strengthened the desire of their peoples for a more diversified industrial life. Americans and Britains have actively assisted and promoted the attainment of this desire by the establishment of munitions plants, airplane factories and other enterprises. We have sold to certain Latin American countries entire plants for the production of iron and steel, textiles and other manufactures. In the Middle East, a large number of new industries have sprung up to meet wartime needs. Iran has substantial leather-tanning and boot-making industries, supplying millions of pairs of army boots to Russia. Palestine's new industries include the manufacture of chemicals, cordage, diamond polishing and light engineering. Sheltered from foreign competition during the war, the new industries in these and in many other countries have flourished. When peace returns, we may expect that they will demand continued protection, especially in the form of import restrictions, and they may be supported in this demand by a strong public opinion which sees in increasing industrialization via tariffs possibilities for raising standards of living. The undeveloped countries are aiming to achieve what they call economic independence, through diversification of production. Now they have most of their eggs in one basket. As producers and exporters of primary materials, they have been subject to disastrous variations in world markets. Bolivia now depends on tin, Brazil on coffee, Malay on rubber, etc. More factories producing cotton and woolen cloth, stoves, automobile tires and a great variety of other goods, would open new opportunities for employment not only in the

industrial plants, but also in service industries in the newly created urban centers.

It has sometimes been argued that when all the so-called backward countries become industrialized, international trade will decline. This might be true if international trade consisted primarily of the exchange of raw materials for manufactures. In fact, however, the most active areas of trade are found in exchanges between industrial countries. A recent study of the trade of 47 countries covering the years 1925 to 1937 shows that the traditional type of exchange of manufactured goods against raw materials and foodstuffs accounted for only one-third of their total trade. Hence we may expect that the introduction of new industries into Latin America, China, Africa, India and other countries which are now predominantly agricultural will open new opportunities for profitable exporting and importing. The process of industrialization, however, will raise new problems of trade policy. We have observed above that investment and trade supplement each other in increasing productivity. In the early stages of industrialization, when new industries are being established, it may be desirable to grant them governmental assistance. There is, of course, grave danger that, moved by considerations of national prestige and by the pressure of business interests, countries may in the early stages of industrialization use trade barriers to establish and to sustain uneconomic industries badly adapted to local conditions. But if assistance is granted with restraint, preferably by subsidies and perhaps under the guidance of an international agency . . . the eventual effect should be the expansion, not the limitation, of the total volume of international trade.

107 · THE COMPETITIVE STRUGGLE FOR MARKETS

JOHN MAYNARD KEYNES

WAR HAS SEVERAL CAUSES. Dictators and others such, to whom war offers, in expectation at least, a pleasurable excitement, find it easy to work on the natural bellicosity of their peoples. But, over and above this, facilitating their task of fanning the popular flame, are the economic causes of war, namely, the pressure of population and the competitive struggle for markets. It is the second factor, which probably played a predominant part in the nineteenth century, and might again, that is germane to this discussion.

I have pointed out . . . that, under the system of domestic *laissez-faire* and an international gold standard such as was orthodox in the latter half of the nineteenth century, there was no means open to a government whereby to mitigate economic distress at home except through the competitive struggle for markets. For all measures helpful to a state of chronic or intermittent under-employment were ruled out, except measures to improve the balance of trade on income account.

Thus, whilst economists were accustomed to applaud the prevailing international system as furnishing the fruits of the international division of labour and harmonizing at the same time the interests of different nations, there lay concealed a less benign influence; and those statesmen were moved by common sense and a correct apprehension of the true course of events, who believed that if a rich, old country were to neglect the struggle for markets its prosperity would droop and fail. But if nations can learn to provide themselves with full employment by their domestic policy (and, we must add, if they can also attain equilibrium in the trend of their population), there need be no important economic forces calculated to set the interest of one country against that of its neighbours. There would still be room for the inter-

national division of labour and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, namely a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle, but a willing and unimpeded exchange of goods and services in conditions of mutual advantage.

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THE ECONOMIC BASIS OF SOUND INTERNATIONAL RELATIONS

ALVIN HANSEN

I HAVE THE STRONG IMPRESSION that many persons vitally interested in sound international relations are too frequently disposed to assume that a high level of economic prosperity in all countries would be assured if trade barriers were largely removed. It is undoubtedly true that the erection of postwar agricultural tariffs, together with the increasingly protectionist policies of many countries, the reparation payments, and the unsound policies pursued with respect to foreign lending, were important factors intensifying the terrific world depression beginning in 1929. While this may certainly be granted, it would be a great mistake to assume that sounder international economic policies of the character referred to above would themselves insure an avoidance of

serious depressions. Indeed, one can go much farther and assert that even in a world that was completely under one political sovereignty the fundamental factor producing depressions would still be present, namely, the fluctuation in the volume of real investment.

In laying plans for a durable peace it would be very dangerous to overlook the threat to the stability of any arrangements that may be made should we experience a recurrence of deep depressions.

I think it is increasingly the view of economists that the depression starting in 1929 is in very large measure responsible for the present plight of the world. There was a very good chance—though no absolute certainty—that in the absence of the great depression a solution might have been found for the central problem of Europe, namely, the place of Germany in international relations. Despite the mistakes of the Versailles Treaty, progress was being made toward a solution in the relatively prosperous years of the late twenties, and could this prosperity have been maintained on a fairly high level, it is not unreasonable to assume that, progressively, a solution would have been found and war thereby averted.

The thesis can, therefore, be advanced with a good deal of reason that the really acid test of international economic co-operation runs in terms of deliberate international policy with respect to the control or moderation of depressions.

With respect to the United States, it may be asserted with a good deal of confidence that this country would make no greater contribution toward the solution of the international political as well as economic problems than that of achieving a high degree of internal economic stability at a level of fairly full employment of labor and other resources. It is, I think, a fact that the extraordinary instability of the American economy presents one of the most serious problems confronting Europe and, indeed, the whole world. The great depression itself was, of course, a result of the interplay of a great many factors, partly internal and partly international, but there can be little question that the tremendous investment boom of the twenties in the United States (and in other countries fostered by American foreign loans), the succeeding high degree of temporary saturation and the ensuing collapse in the output of fixed capital goods, particularly in this country, were the central core of the great world depression and determined in the main its intensity and duration. A bad international setup, of course, magnified the impact upon the outside world, and this impact in turn reflected itself back upon our own country in a cumulative fashion. Thus, as always in a depression period, it is quite impossible to unravel the interplay of cause and effect relationships. But through it all it is

important to see the internal situation in the United States which would have created a profound depression regardless of the international setup.

Europe, and the primary-producing countries as well, from whom we import so heavily and whose prosperity or depression is, therefore, in large measure a reflection of our own, have every reason to fear the impact of America upon world affairs if we continue a high degree of economic instability or chronically depressed conditions as in the interwar years.

It is a striking fact that the movements of the Federal Reserve index of industrial production in the last decades bear a close resemblance to the movements in the quantum of world trade. A sharp depression in the United States spreads to the rest of the world through the sudden decline in American imports induced by our depression. A low rate of activity in America inevitably throws the American trade and service payments on international account into disequilibrium. A violently fluctuating American economy is a menace to economic stability in the rest of the world. A chronically depressed America, unless the world can in some manner isolate itself from this depressional influence, tends to infect other countries.

Under these circumstances it is highly probable that unless the United States can do a better job of managing its own economy and can effectively co-operate with other countries on monetary policy, fiscal policy, and on a co-ordinated international program of expansion and development to combat depression and unemployment, it will become necessary for foreign countries to insulate themselves as far as possible from the American influence. It is by no means improbable that without an adequate internal American policy, combined with international collaboration along the lines indicated, the European countries will find it essential to their political and economic stability to collaborate on policies designed to segregate themselves economically from the United States. This would indeed be a world tragedy.

Through management of the exchange rate and other controls elaborated during the period of the war, it is not improbable that there might be integrated into a fairly unified system a considerable international area, including not only the British Empire and the countries of western Europe but also at least that section of Latin America whose trade has always been closely linked with England and western Europe. Such a quasi-union would embrace a very considerable part of the modern industrial world. But with the United States left out we should have world chaos.

All countries are aware of the economic difficulties that will con-

front them at the end of the war, particularly the danger of mass unemployment. In addition to political reconstruction, bold economic and financial planning on a world-wide scale is required, involving international developmental projects and internal domestic programs to promote high levels of production and rising living standards. International collaboration with respect to internal expansion within each country must, moreover, be undertaken with a view to the promotion of international equilibrium.

* * * *

Undoubtedly, intelligent opinion throughout the world eagerly hopes and plans for international collaboration with the United States. But this is true only on the assumption that there is reason to suppose that the United States can and will stabilize its economy at a high employment level and that it can and will participate in effective international collaboration along monetary, trade and fiscal lines.

What I have tried to state briefly is my conviction that it is necessary to think of international economic co-operation in more thoroughgoing terms than has commonly been the case. It is important not merely to think in terms of the optimum international division of labor which at full employment would give us the largest realizable real income. In the kind of world in which we live today it is even more important to realize how difficult the goal of full employment is and to consider those domestic and international policies that will tend to promote this end.

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THE WORLD FINANCIAL SITUATION AFTER WORLD WAR II

ROGER AUBOIN

WHEN THE SECOND WORLD WAR WAS OVER and the question arose what economic and financial policies should be pursued, one of the dominant ideas, firmly rooted in wide and influential circles, was that the world economy was heading for a serious depression, which would make its appearance in the very near future and bring back the terror of unemployment. With the prolonged crisis of the 1930's still a living reality in people's minds, these forecasts and fears created something of a psychosis.

In order to be able to stave off a repetition of the losses and sufferings experienced in the years before the war, those in authority were, in most cases, bent on pursuing a cheap-money policy and financing investments by much the same methods as had been employed during the war. Any danger of inflation could, they believed, be counteracted by administrative control over trade and prices; this had proved useful during the war and it was commonly thought that it could be continued in time of peace. In relation to other countries, emphasis was laid on the attainment of exchange stability in terms of official rates (in order to avoid "chaos") rather than on creating a true exchange market, which would have enabled currencies to be used on a multilateral basis for current transactions and a reasonable volume of capital transfers. Efforts were directed mainly towards an incease in production, it being thought that, if only output rose, inflation would be checked, even though the new plant and equipment were financed by the creation of fresh money.

But instead of falling, prices continued to rise—more slowly in some countries, more rapidly in others, the cost of living being kept down

rather by the granting of food subsidies (which were a heavy burden on the budgets) than by the operation of systems of control (which under peace-time conditions could not be made very effective). The continued influence of inflationary forces, whether "repressed" or allowed to affect prices, necessarily led to losses of monetary reserves for most European countries—one financial crisis following the other, especially in the field of foreign exchange, until, in the difficult year 1947, a real breakdown in international trade and payments seemed imminent. The threatened calamity, which would have had serious repercussions on the domestic situation in the countries concerned, was, however, averted by a series of fresh efforts, varying in form from country to country but all having as one of their principal aims the prevention of any further inflationary expansion of credit. Internationally, a new venture, commanding resources far beyond the means of existing institutions, was launched under the name of Marshall aid. Nationally, a new note was struck by several countries: in the United Kingdom a real overall surplus was established in the budget and artificial support was withdrawn from long-term interest rates on the London market, while in Italy, and afterwards in France, stabilisation was attained with the help of credit restrictions.

The result of these international and national efforts was great progress, not only in production and investment (of which the full fruits have yet to be seen) but also towards a better internal equilibrium —inflationary pressure being increasingly brought under control. For the most part, however, the real mechanism of adjustment, in the form of a flexible interest policy and of a genuine exchange market, was still out of gear. So it happened that the façade of exchange stability could offer little resistance to even a moderate degree of strain. Never in the history of the world have there been more frequent alterations in exchange rates than in the period of official stability after the second world war.

After the devaluations in the autumn of 1949, however, a period of more solid progress seemed to be bringing a real stabilisation within reach. An increase in domestic production went hand in hand with a reconstruction of monetary reserves and was accompanied by a relaxation of control as regards the internal relations of certain areas and a liberalisation of trade within their bounds. In addition, a number of countries on the continent of Europe began to allow free repatriation of their bank-notes—a development which helped to narrow the margin between official and free-market quotations and, in particular, to ensure a more ready flow of foreign exchange into official channels.

Many tasks still remained, however. Since restrictions imposed by

other countries in relation to the dollar area had been relaxed only to a small extent, foreign competition was prevented from producing its full effect, and this meant a limitation of the international division of work, with a consequent reduction in the general level of efficiency. As long as liberalisation was confined to a particular group of countries, it was inevitable that a number of difficulties would arise, particularly since the countries belonging to this group had not all attained the same degree of exchange stability and had not all relaxed their restrictions vis-à-vis the dollar area to the same extent.

Then in the middle of 1950 the world was faced with a fresh rearmament effort without having had time to re-establish its economy on a truly sound basis after the last conflict. Clearly, the goal of the present efforts should be to avoid another war—and the measures in which the countries place their reliance ought, therefore, to be such as would, to the greatest possible extent, be compatible with continued economic progress and especially with exertions sustained over a prolonged period.

It would, in particular, be a fatal error to believe that the methods of financing and the controls which had been applied during the second world war could be usefully employed in time of peace, even if it were an "armed peace." It is essential for the purpose of maintaining the effective strength of the various countries that the rearmament effort, initiated as it has been for the sake of security, should steer clear of inflation, with all the perils and chaotic conditions which its recurrence would involve. For a relapse into inflation would weaken the social and economic structure—and the countries with a relatively free system are even less able to afford such a loss of strength than those which adhere to a collectivist type of economy. In the conditions which have arisen there is clearly a need for much "true planning," based on a careful calculation of the resources really available and on a determination to face the difficulties that have to be overcome. Confronted as they are with the increased cost of armament, the countries will have to inaugurate a stiffer budget policy, with heavier taxation and curtailment of non-essential expenditure. But, considering the heavy burdens already borne in more than one country, it seems impossible to expect that the increase in government expenditure will everywhere be met by higher current revenue. Some government borrowing would seem to be inescapable and, this being so, it is of the greatest importance that no methods of financing should be used which would lead to inflation; in other words, there should be neither direct nor indirect recourse to the central bank. Because of the increased resources to be devoted to armaments, it will clearly be necessary to curtail lending for other

purposes, and one of the main ways of achieving that result will obviously be the application of a restrictive credit policy. In this connection mention may be made of the experience of several countries which, with the aid of a careful credit policy, have been able to restore and maintain balance in their internal economies, even though they have not managed to rid themselves completely of the deficit in their budgets.

In certain countries the conditions for the pursuit of a successful credit policy are today more propitious than they have been at any time since the war:

(i) The excess of money which was a general feature just after the war has been practically eliminated in most countries; thus a condition without which the ordinary instruments of credit policy cannot regain their effectiveness is on the point of fulfilment.

(ii) Quite a number of countries have succeeded in building up fairly substantial reserves and have in that way acquired greater opportunities of exerting an influence on credit conditions in their markets.

When countries with weak monetary reserves encounter difficulties in their balances of payments they have obviously particularly strong reasons for the application of a restrictive credit policy. But, in real life, such countries are apt to rely upon direct measures (only too often in the belief that this might relieve them of the need for contracting credit at home), while the countries with stronger reserves feel that they have something to lose and, therefore, something to defend. But it is now becoming more generally recognised that, when reserves have to be used to meet foreign payments, decisive steps must be taken to ensure that funds are withdrawn from the domestic market; the proof of this change of attitude is that central banks have been increasingly prompt to take the necessary action by raising their discount rates and limiting the granting of fresh credits in other ways. It may be recalled that in the years 1945-47 the central banks in Belgium, France and Italy had already raised their discount rates; they have now been followed by the monetary authorities in Canada, Denmark, Finland, Germany, the Netherlands, Sweden and the United States, and the list could be lengthened if account were taken also of the countries which (like the United Kingdom) have allowed an increase in their long-term interest rates or applied more direct methods of curtailing credit to consumers, the building trade, etc.

This is a development of great importance as laying the foundation for a non-inflationary financing of the armament effort on lines which

represent the abandonment of obstinate adherence to a cheap-money policy that had been one of the essential tenets in the financing of the last war. An influence thus being more definitely exerted through general financial action, it becomes less necessary to introduce a host of individual control measures, and this applies also to the unavoidable curtailment of investments. In this connection it must be noted that the need for such a curtailment cannot be blamed on credit policy. The truth is, of course, that investments have to be kept within limits compatible with the amount of capital available from domestic savings or foreign sources. No doubt it is regrettable that a deficiency of real resources has made such a curtailment necessary; but past investments will still yield results, and there are fortunately various means of a different character by which the effectiveness of production can be enhanced. Governments and business leaders do not seem as yet to have quite got rid of their obsession with the idea that a serious post-war depression is to be expected in the not very distant future and that it may therefore be wise not to push on too far with the output of agricultural and other products. In addition to the change called for in this fundamental attitude towards production, there is also need for the discontinuance of more specific ways of limiting production and trade—ways which often involve a certain measure of price support. It is a fortunate circumstance that the taking of steps in relation to these matters does not as a rule require any additional outlay of capital.

There is a further way of strengthening incentives to higher productivity and that is by the restoration of free scope for foreign competition through the relaxation if not the complete weeding-out of import restrictions. Too long have foreign influences been kept out of the home markets, and especially influences from the dollar area; since manufacturers in Europe will anyhow have to compete with dollar-area producers in third markets, there is a strong case for extending the salutary effects of this competition. When there is a danger of their being crowded out, this often spurs people on to greater efforts than any other incentive. Some new capital for the introduction of fresh methods of production will no doubt be required, but a number of enterprises will very likely be able to secure the necessary funds by ploughing back profits and, in general, it may be said that no better use can be made of limited resources than to devote them, in the first place, to an improvement in technique, whether it is a question of production or of marketing.

It is one of the merits of the more careful credit policy which is now being adopted in so many centres that this policy facilitates the task of relaxing restrictions on trade and foreign payments and thus enables

the countries in question to take fuller advantage of an expansion of the international exchange of goods and services.

It will certainly not prove easy to remove the indirect protection afforded by the existing exchange restrictions (particularly those in relation to the dollar area) now that so many vested interests are flourishing inside the fence of the exchange control. But the attempt must be made and must succeed. The most effective use to which the remaining foreign aid and the more plentiful reserves can be put is to employ them in decisive steps towards the re-establishment of genuine exchange markets and towards securing a significant relaxation of the restrictions hampering trade and payments between Europe and its overseas territories, on the one hand, and the dollar area, on the other. Progress along such lines is, indeed, an essential condition for the attainment of a lasting economic co-operation in Europe; for the structure of this continent is such that no form of integration will prove sound and durable if it is in any way fashioned on the lines of a closed area.

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THE INTERNATIONAL SUGAR COUNCIL

The International Sugar Council was established pursuant to the International Sugar Agreement signed at London, May 6, 1937, which came into force September 1, 1937. The agreement has been extended annually by Protocols. The International Sugar Agreement was developed after a long period of recurring crises in the sugar industry. Various attempts were made to draw up inter-governmental agreements designed to establish an equilibrium in world markets between supply and demand. These resulted in the Brussels Sugar Convention of 1902, which was European in scope, and the Chadbourne Agreement of

1931, signed by the chief sugar-exporting states. The International Sugar Agreement of 1937 was negotiated pursuant to a recommendation of the World Monetary and Economic Conference of 1933 and supersedes these other agreements.

The original membership of the International Sugar Council included the governments of the principal sugar exporting and importing states. The agreement is open to accession by the government of any metropolitan territory, other than a signer of the agreement, providing conditions of accession have first been agreed upon with the Council. The original members of the Council are listed below: Australia, Belgium, Brazil, China, Cuba, Czechoslovakia, Dominican Republic, France, Germany, Haiti, Hungary, India, Netherlands, Peru, Philippines, Poland, Portugal, Union of South Africa, Union of Soviet Socialist Republics, the United Kingdom, the United States, and Yugoslavia.

The purpose of the International Sugar Council is to administer the International Sugar Agreement, which is designed to establish and maintain an orderly relationship between the supply and demand for sugar in the world market at prices which will be equitable both to producers and consumers. In addition to estimating free-market sugar requirements and securing the accession of non-signatory governments, the Council is authorized to obtain and publish appropriate statistics, to approve the budget, to appoint officers and working committees, and otherwise to carry out the terms of the agreement. Its terms of reference provide that the council shall:

a) make a full study, acting if it considers it desirable in conjunction with appropriate international organisations such as the International Institute of Agriculture, of the various forms of state assistance in order in particular to formulate proposals for carrying out the principle laid down in Article 4, taking into account the varying conditions under which sugar production is carried on, and in particular, the conditions of agricultural production; b) enquire into the effect on the free market of direct or indirect premiums granted to sugar-producing industries in general; c) examine the possibility of promoting between white-sugar exporting countries reciprocal agreements to respect their national markets; d) collect available information in regard to the matters dealt with in Article 5 (*i.e.,* the possibility of expanding consumption); e) submit the results of enquiries made in regard to the matters dealt with in this Article for the consideration of the Contracting Governments.

The Council is composed of delegates representing the contracting governments. There is also an Executive Committee, composed

of nine members representing three importing states, and three beet-sugar producing states. The United States and the United Kingdom have permanent representation as two of the importing states, and Cuba and the Netherlands have permanent representation as two of the three cane-producers. The third importing representative is selected by all importers other than the United States and the United Kingdom, while the remaining representatives are designated by rotation. The Executive Committee exercises any powers which may be delegated by the Council except for changing quotas and determining conditions for new accessions. The chairman of the Council is *ex officio* chairman of the Executive Committee, which precludes other representation of his government on the Committee.

The Council meets at least once a year, but it may be convened at any time by the chairman. At the request of the Executive Committee or five contracting governments, the chairman immediately convenes a meeting of the Council.

The official languages of the Council are English and French. . . .

Budget. The annual budget is approved by the Council. The Agreement of May 6, 1937 states that the expenses shall not exceed £12,500 ($50,406) in any year without the express consent of all the contracting governments.

The budget of the International Sugar Council for its fiscal year ending August 31, 1949 amounted to £9,440 ($38,067), as compared with an approved budget of £7,840 ($31,615) for its fiscal year 1948. All expenditures are financed by contributions from member governments.

Members' Quotas. The contribution of each member government, as decided by the Council, is proportionate to the number of votes to which its delegation is entitled. This number is based upon its relative status as an exporter or importer of sugar.

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Authorization. Following the advice and consent of the Senate, the instrument of ratification of the International Sugar Agreement of 1937 was deposited by the United States on April 4, 1938. Since all countries had not deposited ratifications of the Agreement by September 1, 1937, as required by its terms, it did not come into force on that date. The United States however, under authority of the Sugar Act of 1937, cooperated in the international regulation of the production and marketing of sugar and participated in the International Sugar Council (along with certain other countries, which by reason of declarations had provisionally brought the Agreement into force

in respect of those countries as from September 1, 1937). Subsequently, at London in July 1942, the countries which had deposited ratifications of the Agreement (including the United States) signed a Protocol, which in addition to prolonging the Agreement after August 31, 1942, provided that it should be regarded as having entered into force on September 1, 1937, in respect of the Governments signing the Protocol. Protocols extending the life of the Agreement have been signed annually. . . .

PAYMENTS. The United States contribution is paid from funds appropriated to the Department of State. The United States quota for the Council's fiscal year 1949 amounted to £2,006 ($8,089), or 21.25 percent of total assessments.

AGENCIES CHIEFLY CONCERNED. The Department of State and Agriculture are primarily concerned with the formulation of United States policy in the International Sugar Council and with participation in its meetings.

PARTICIPATION. The United States participates in the work of the Council by the designation of official representatives having full voting rights.

The Sugar Council has working agreements with the statistical office of the United Nations and with the Food and Agriculture Organization, defining their respective responsibilities with regard to collection of statistics, distribution of information, et cetera, and has established a policy for reciprocal exchange of publications. It has been agreed that the Sugar Council shall collect all statistical data relating to sugar which will be required by either organization. The Statistical Commission of the United Nations has recommended that the Statistical Bulletin of the International Sugar Council be published monthly, as before the war, instead of on the present quarterly basis. The fact that the Sugar Council collects these data relieves the Food and Agriculture Organization of the necessity for doing so. Representatives of United Nations and FAO are invited to meetings of the Sugar Council and vice versa.

The Interim Coordinating Committee on International Commodity Arrangements (ICCICA), established by the Economic and Social Council of the United Nations, is entitled to representation at meetings of the Sugar Council and maintains a general liaison relationship.

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POUNDS, DOLLARS, AND OURSELVES

J. B. CONDLIFFE

THE EXCHANGE RATE is the price of one currency expressed in terms of another. When the pound sterling exchanged at four dollars and three cents, all British prices translated into American money at that rate. When this rate is altered, that is, when currency is devalued, it transposes the whole range of national costs and prices into a new key. Not only goods but tourist services, freight rates and airline fares, insurance charges and loan payments—all international transactions—are affected. All transactions crossing national boundaries come to a focus in the exchange rate. Devalution, therefore, is a drastic step with results not entirely predictable.

Anyone who tries to analyze the probable effects must sympathize with Alice who found that "whenever she looked hard at any shelf, to make out exactly what it had on it, that particular shelf was always quite empty, though the others round it were crowded as full as they could hold."

When the dollar-sterling rate was altered on September 18, 1949, from $4.03 to $2.80, some elementary calculations could be made. If there were no change in British prices, the same volume of exports to the United States would earn 30 percent less in dollars. Conversely, it would cost 44 percent more in sterling to buy the same volume of dollar imports. To earn as many dollars as before, either the price or the volume of British exports would have to be increased by 44 percent. A bushel of wheat at $1.80 cost nine shillings at the old rate, but nearly thirteen shillings at the new rate. This, however, was only the beginning. Wheat purchases could be shifted from the United States to Canada, or, better still from the British point of view, to Australia or Argentina.

At the same time, there were interesting possibilities of selling such things as wool to the United States—"Crabs, and all sorts of things," said the Sheep to Alice, "plenty of choice, only make up your mind. Now what *do* you want to buy?" It was not easy to make up one's mind. Time was necessary to allow different reactions and combinations of price changes and demand elasticities to work themselves out. As Alice complained, "Things flow about so here." It was possible that wool would be sold in larger quantities; but it was also possible that the effects of devaluation would be that after catching some crabs, the currencies would drift along a stream fringed by dream-rushes; the prettiest always farther on, and all fading as soon as picked, something that Alice hardly noticed after awhile because "there were so many other curious things to think about."

Obviously, no country would take such a serious step as devaluation unless it was the least evil of the choices by which it was confronted. The Chancellor of the Exchequer, Sir Stafford Cripps, had been resolutely opposed to it until about the middle of August, when he found that the drain on British dollar assets had gone too far to be checked in any other way. For years Britain had been importing more from the United States than could be paid for with the dollars earned by British exports to the United States. In the summer of 1949 the talk of devaluation increased. Officially, the United States was careful not to press the British; but individual Americans expressed the belief that devaluation was inevitable.

When official statistics revealed that Britain was losing gold steadily, traders ceased to buy, or placed orders to be filled after devaluation. The Black Markets in New York and on the Continent had been quoting the pound at \$2.80. There was a great deal of speculation, largely through the markets for goldmining shares. The British people had to be fed and materials had to be imported; but exports fell heavily. Dollars were going out in steady volume, but few were coming in. It was the worsening of this situation that made the decision to devalue inevitable.

Eighteen years earlier, almost to the day, in September 1931, sterling had been devalued under somewhat similar circumstances. But in 1949 there was a great difference. Instead of devaluation coming at the trough of depression with great unemployed resources that could be used to produce more exports, it came this time when labor and resources were stretched to the limit in an over-employment boom. There was little possibility, therefore, that new production could be put in hand to take advantage of the new competitive possibilities in the United States markets. If exports were to be increased to the United

States, they had to be diverted from other markets. Since the war ended, British manufacturers had been fully occupied. Full employment in the domestic market had provided purchasing power for the bulk of their production.

Another large outlet had been the sterling paid to dominion and colonial suppliers of the food and raw materials imported into Britain. Australia and New Zealand, for example, had negotiated long-term bulk-purchase contracts to sell all their exports of meat and butter and cheese to Britain. Both had accumulated large sums of sterling in London, against which payments could be made for British exports. In addition, there had been a considerable volume of unrequited exports from British factories. Some had gone in the form of capital expenditures on colonial development programs. Most, however, had been in liquidation of the blocked sterling balances held by such countries as India, Eire, and Egypt.

The blocked balances were debts incurred by Britain during the war. At the end of the war they amounted to about sixteen billion dollars; but they have now been reduced to about twelve billions. This was a tremendous amount to go out—largely in the form of exports without corresponding imports. It helped to keep employment (and inflationary pressures) high in Britain; but many British economists feel that it was the root of the difficulties that made devaluation inevitable last September.

One other preliminary point must be noted. This was not just a devaluation of sterling. Britain is still the center of a great trading system. The cohesion of this grouping of countries to which the British import market is of dominant importance was dramatically illustrated once again. As in 1931, so in 1949, this large area, conducting about 60 percent of the value of world trade, devalued simultaneously against the dollar. When one remembers that the countries within the Soviet bloc account for 6 percent of the world's trade and the United States itself accounts for 17 percent, this doesn't leave much for a possible dollar area. It becomes apparent that the devaluations that have already occurred amount to an appreciation of the dollar in all trading currencies except a few in Latin America, Switzerland, Pakistan, Iran, Poland, and Czechoslovakia. This fact may be put in another way. If the countries which devalued a few months earlier are included, devaluation has now taken place over an area which, in 1948, took about 72 percent of all United States exports. In those countries American goods will now be 44 percent dearer and exports must be expected to decline.

The theory of devaluation is simple. *When a country reduces the*

value of its currency in terms of other currencies, there is a presumption that by cheapening its export prices it will gain larger markets. Or by making imports more expensive it will reduce them.

Looking at this from the point of view of the United States, the theoretical expectation would be for a larger volume of imports at prices lower in dollars than before devaluation. Conversely, there would be greater difficulty in selling our exports abroad.

Insofar as these expectations are realized, certain desirable results will follow (though not without cost). The tropical colonies will send more rubber, tin, zinc, and similar products to the United States. Australia, New Zealand, and South Africa will send more wool, rabbit fur and—if not prevented by bulk-purchase agreements—more butter, cheese, and meat. In all these cases there will be a fall in dollar prices, even though prices rise somewhat in the depreciated currencies. This will be coupled with increased exports to the United States. To some extent, this is already happening. The price of rabbit fur, out of which our felt hats are made, has risen in Australia and New Zealand by 20 percent, but is still cheaper in dollars since the currencies have been devalued by 30 percent. There will be increased dollar earnings on this item, and an even more important increase on wool, which also has risen by 10 to 20 percent in Australia. On the other hand, these price increases will be reflected in British costs of production, so that it will not be as easy for British manufacturers to expand their exports to the American market. They will continue to export to the dominions and colonies, and these in turn will increase their exports to the United States.

It should be recognized, on the other hand, that these trends towards multilateral trade will meet very strong obstacles in the shape of political controls. Approximately 60 percent of British imports are now subjected to bilateral bulk-purchase arrangements. These cover a large proportion of the exports from the dominions and colonies and also from such countries as Denmark, Norway, Argentina, and Uruguay. For example, New Zealand sends all butter exports to Britain under a seven-year contract which still has five years to run. The price at which butter is landed in London was equivalent before devaluation to about 35 cents. It is unchanged in New Zealand currency and in sterling; but is now equivalent to 24½ cents. The wholesale price in the United States is now much lower than it was in the immediate postwar years, but it is still double this London price. The tariff has been reduced to 7 cents. It is obvious that New Zealand could export large quantities of butter profitably to the United States and thereby earn large amounts of dollars.

But political difficulties emerge. The New Zealand population is rationed, so as to maximize the amount of butter available to Britain. It is improbable that this rationing could be maintained if large quantities of butter were sent to the United States. Moreover, our Department of Agriculture holds over 70,000,000 pounds of butter in storage, as a consequence of the price falling below parity. For all such commodities, import licenses are required, and it is unlikely that the recent cut of 50 percent in the tariff duty can be effective as long as import licensing is in force.

On both the British and the American side, therefore, existing trade controls make it difficult to divert trade into multilateral channels. Without such diversion it is unlikely that United States imports will yield more dollars than could have been earned at the former exchange rate. The elasticity of supply is not great. The dominions, too, are in a full employment boom.

Moreover, emphasis must be laid on the fact that American imports of industrial materials such as wool, rubber, tin, and zinc are *income-elastic*. What this means is that the volume of imports depends markedly upon the level of purchasing power in the United States. Even a slight recession in this country causes a sharp decline in the imports. This was one of the main contributory causes of the sterling area dilemma which forced devaluation. The falling off of dollar earnings from the tropical dependencies was estimated in 1948-9 at about a hundred million dollars. It is obvious, therefore, that one of the main keys to the success of this devaluation is that income and purchasing power, and therefore imports, must be kept high in the United States.

As the recent Report of the Economic Cooperation Administration-Department of Commerce Mission clearly indicates, the United States can and should import more. The main fields in which imports may be increased are three—tourist services, industrial materials, and manufactured goods designed for specialized purposes or requiring specialized skills or unique raw materials for their production.

It has already been pointed out that industrial materials offer the greatest opportunities to increase dollar earnings; but that there are economic and political difficulties in the way. This is true also of tourist and other services, particularly freight rates and passenger fares, both by ship and airplane. Hotel accommodations must be expanded, new ships and airplanes must be built, advertising and similar services must be increased. There are competitive United States services which will be forced, in most cases, to meet the increased competition by lowering their prices. In some cases, the fares on British and other European ships will be increased by the amount of devaluation.

The possibilities of direct export from European countries to the United States are mainly in specialty lines of manufactures. These possibilities should not be exaggerated. The example of Scotch whisky is instructive. The British exporter has been receiving, landed in an American port, a dollar a fifth. The remainder of the cost of a bottle of whisky to the American consumer consists of duty, taxes, landing charges, freight, retailing, advertising, and other costs of distribution—all payable in dollars and unchanged. If the British exporter passed on the full extent of the devaluation to his American customer, it would be 30 percent of one dollar. The exporters decided, quite rightly, that the extra sales volume, if the retail price fell by 30 cents, would be insignificant.

In the language of economics, the demand for whisky is not *price-elastic*. Therefore the dollar price was kept as it was and the exporters pocketed the sterling profit. An additional reason was that the supply is inelastic. The makers are already selling all the whisky that is ready for export and cannot quickly increase their production of the matured article.

Despite slaughter sales immediately after devaluation, this pattern is likely to be followed in many manufactures where the demand is dependent upon quality or prestige rather than price. In addition, it is probable that sterling costs in some measure will rise. Three factors need to be taken into account here.

First, all manufacturers who depend upon imported materials will find their costs increased to the extent that materials are diverted to the United States. Time will tell how important this diversion may be. It will depend partly upon national income and employment being maintained in the United States at levels which call for large imports of materials. Largely also it will depend upon the extent to which British (and other European) manufacturers can rely upon local materials, or upon those imported from the area of devaluation, which have not risen too sharply in price, dispensing with American imports as far as they can. It will take some months to see what kind of combination works out and what effects this has upon European costs.

The second factor is more important. If devaluation is to be effective, it must not be counteracted by a rising price level. This means that the devaluing countries must resist all attempts to raise money-wages. In other words, they must inflict upon their workers a reduction in real wages.

The price of bread in England went up immediately because wheat imports from the United States became more expensive. The Chancellor

contended that no other prices should rise. He based this claim upon the fact that the major imports were governed by bulk-purchase agreements with countries that had also devalued. To the extent that these agreements are honored, exports cannot be diverted to the United States and one of the main purposes of the devaluation is thwarted.

But there will be some diversion, and some European import costs will rise. Then the workers must either accept lower living levels or, by demanding higher wages, put up production costs and thus nullify any price advantage that may be gained by devaluation. One of the first effects of this dilemma was the fall of the French government.

The British political balance more stable than this is an issue that will not be decided by parliamentary votes of confidence. Wage negotiations will tell the tale in the next few months. It is asking a great deal of the workers to expect them to accept the same wages when prices are going up. Moreover an effort must be made, and is being made, to cut public expenditures, notably in the subsidies which have kept food prices low. There is no escape from this lowering of living levels. It is not the result of devaluation; it is the result of the impoverishment of the European countries by wars and of the economic controls which have postponed the necessity of facing up to this impoverishment. Devaluation is only a means whereby unpleasant facts may be faced and their consequences spread over the whole community. If rising wages counteract the fall in living levels, devaluation will not have helped.

The third factor to be remembered is that a great effort is necessary if European exporters are to break into the United States market in any marked degree. This effort must be made first of all in the factories by adapting products to fit the American consumer. Devaluation cuts the price, though only in respect of sterling costs. This gives a chance to sell more. But the United States consumer expects a greater degree of standardization than is common in Europe. In default of standardization of patterns and qualities and a steady flow of quantity production, goods may be sold in small parcels as specialties; this, of course, will require a greater effort of merchandizing within the United States. It is not enough to deliver the goods to an agent at an East Coast port. If this continental market is to be covered, there must be selling campaigns, local agents, advertising, personal visitation. All this costs dollars. Still more, it calls for energetic personal effort.

It could be done. The ECA-Commerce report cited above is emphatic on this point. But the report also gives a long list of defective trade practices that must be improved—lack of aggressive selling, of

distribution outlets, of personal study, of trade promotion facilities, of suitable packaging and display. The suggestions are made under different heads, which are significant: What European Governments Can Do, What European Business and Labor Can Do, What U. S. Business and Labor Can Do. The United States government also has a role to play in further reducing tariffs and in simplifying valuation and import procedures. Finally the Organization for European Economic Cooperation must bend every effort to make one great producing and marketing region out of what are still conflicting sovereignties. The barest recital of these necessities is enough to show that devaluation is not a cure-all. It has set the stage but the play has yet to open. Exports will not sell themselves.

All the discussion preceding has been centered upon the possibility of increasing imports into the United States. It seems probable that there will be some increase. For the most part, it will be in the form of materials and, to some extent, services such as shipping and airline traffic and increased expenditure by United States tourists. The imports of manufactured goods competitive with established United States industries seem unlikely to increase much. That competition is likely to be most intense in third markets such as Latin America. But on the domestic scene it must be recognized that the import competition will be most severe precisely in the industries that are already vulnerable. It will therefore cause renewed demands for protection. The sheep-raising industry will be hit worse than ever by increased imports of cheapened Australian wool. The olive oil and nut industries of California will suffer from Mediterranean competition.

On the manufacturing side, it will be such industries as watchmaking and textiles that will bear the brunt—all the industries where high-priced American labor constitutes a large proportion of production cost. Economists may argue that these industries do not have a comparative advantage in the United States and ought not to be protected; but the craft trade unions and the manufacturers whose investment is at stake do not take kindly to this argument. If the consequences of devaluation are not counteracted by increased protection, the costs of adjustment will fall largely upon these competitively weak industries. As was shown by the recent agitation to prevent the closing down of mills in Nashua, this may involve much hardship locally.

The extent to which imports will disturb production and employment in the United States is probably not as great in the aggregate as may appear from its concentration upon a few industries. Much will depend upon how the national income stands up. The propensity of

the United States to import is much more *income-elastic* than *price-elastic*. When the volume of business is running high, imports are large. This is true of industrial materials such as wool and rubber; also true of tourist, shipping, and other services; and almost equally true of most of the imports of specialty manufacturers and novelties. There is little likelihood that European countries can compete effectively on their home ground with United States corporations producing large-scale manufactures. The specialities are responsive in some degree to price cuts, but they are bought most freely when incomes are high. This accounts for the fact that imports are largest when domestic production and prices are high—both responding to active business conditions.

How will the devaluation of foreign currencies affect the national income of the United States? Primarily through its crimping of export markets. Here we come up against the hard fact that the destructive effects of such a change are certain and immediate. The constructive possibilities are uncertain and delayed, being dependent upon other actions to follow up the openings for new trade presented by devaluation.

The Europeans will suffer a reduction in their living levels. Americans will suffer a sharp decline in export outlets. These effects are certain. They are under way already. The decline of exports will hit some industries in the United States very hard. The dried- and canned-fruit exporters in California were already badly off, with surpluses piled up. The apple-growers and now the orange-growers have joined the long list of producers who are being helped by export subsidies up to 50 percent of the parity price. There are surpluses of tobacco, cotton, and corn (and therefore of lard). Next year there will be a surplus of wheat.

* * * *

Here is the crux of international politics as well as international economics. Devaluation has perhaps precipitated, but has certainly not created, the economic maladjustment between the United States and the rest of the world. The United States cannot maintain itself as an island of high productivity and high prices—a high-cost economy—in a sea of poverty and prices reduced in dollar terms.

Unless the United States can make adjustments in its own economy, changing its pattern of production and lowering its prices to competitive levels, trade will not flow freely and the disequilibrium in international payments will not be solved. To do this suddenly would run

the risk of precipitating depression in the United States. One must remember that 1933 followed 1931. What seems more probable is an attempt, within the United States, to stave off depression by what are essentially inflationary measures of deficit financing—price supports and public expenditures to sustain employment. The effectiveness of such measures can be only temporary.

Moreover, the devalued countries, which now have at least a temporary advantage over American exporters in third markets, may be able to build a fairly substantial region of multilateral trade, ready access to which is denied to the United States by its own price policies as much as by trade restrictions. There is still great cohesive strength in the sterling area, which could again be the nucleus of a modified world trading system.

The adjustments, and possibly the ultimate costs, resulting from devaluation must fall in large measure upon the United States. If these are to be met without causing either depression or a renewal of the inflationary boom, followed inevitably by an even worse depression, decisive action must be taken on the international level.

Devaluation has merely altered the values of the tokens in which the international game is played. It must be followed by action in regard to agricultural production and prices, employment, investment and, above all, trade. A great effort is called for to make the trading world one market. This is not easy and the costs will come high. But the stakes are high also.

If the United States tries to perpetuate its high-cost, high-priced economy by producing scarcities, hungry people abroad can hardly be blamed if they conclude that Americans have abandoned the realities of international cooperation and have "placed elsewhere their hope." These are the words Dante used to describe the usurer. However conscious Americans may be of their rectitude and good intentions, as well as their efficiency, it is certain that other peoples will regard them as usurers if once again they tax themselves to keep prices high and production down in a hungry world.

PART EIGHT

Some Special Problems of a Modern Political Economy

IN NORMAN S. BUCK'S COMPILATION of headlines in 1933 (112), one can see at a glance the unrest of the American farmers on the eve of the New Deal. D. Gale Johnson offers a very critical analysis of the farm program (113). Reading 114 describes the effect of mechanization on agriculture. Two celebrated Supreme Court decisions, *Munn v. Illinois* and *Smyth v. Ames,* are reprinted as Numbers 115 and 116. The subject of mobilization is treated in Selections 117, 118, and 119, by Frederic Dewhurst, Charles O. Hardy, and Walter Lord, respectively. In Article 120, Eric Johnston, administrator of the Economic Stabilization Agency, explains the significance of controls.

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(112) Buck, N. S., ed., *Survey of Contemporary Economics,* Nelson, 1934, pp. 363–365. The headlines are taken from the *New York Times Index.*

(113) Johnson, D. G., *Trade and Agriculture,* Wiley, 1950, pp. 92–95.

(114) "Oil and the Farmer," *The Flying Red Horse,* Socony-Vacuum Oil Co., Vol. 16, No. 3.

(115) Sup. Ct. of the U. S., 1876, 94 U. S., 113.

(116) Sup. Ct. of the U. S., 1898, 169 U. S., 466.

(117) Dewhurst, J. H., *et al., America's Needs and Resources,* New York: Twentieth Century Fund, 1947, pp. 651–655.

(118) Hardy, C. O., *Wartime Control of Prices,* The Brookings Institution, 1940, pp. 1–9.

(119) Lord, Walter, *Business Information Service, Defense Production Aid,* U. S. Department of Commerce, Government Printing Office, July 1951.

(120) Johnston, Eric, *Strong Dollars,* Government Printing Office, November 1951.

112 · THE FARMERS' REVOLT IN 1933 AS SEEN IN HEADLINES

N. S. BUCK

JANUARY 15, 1933. FARMERS IN IOWA BAR 2 MORE SALES. 400 Gather at Logan, 1,000 at Bedford—Chattel Auction Blocked at Holstein. Tax Relief Is Demanded. 600 Mass at Clarinda—Closed State Banks to Halt Selling—Nebraskans Plan March.

January 22, 1933. 1,000 FARMERS ACT TO BAR FORECLOSURE. Owner at Wilmar, Minn., Had Tilled Land for 57 years—Action in Other States.

January 22, 1933. FARM CRISIS RISES; LAW BREAKS DOWN. "Holiday" Movement in Mid-West Adds Thousands, with Temper Increasingly Ugly. Public Opinion a Force. Foreclosure Sales Come to Nothing, While Courts and Officers Yield to Farmers "on the March."

January 22, 1933. FARMER UPRISINGS MORE FREQUENT. Movement to Interfere with Mortgage Sales Spreads in Corn Belt. Disorder Seldom Occurs. Most Actions Directed against Sales Ordered under Chattel Mortgages. Object to Save Debtors. Groups Seek to Prevent Deficiency Judgments Which Would Strip Mortgagees.

February 6, 1933. STRIKE OF FARMERS PUT IN ULTIMATUM. Milo Reno, Holiday Leader, Says It Will Be Nation-Wide unless "Quick Relief" Comes. Organizing Now, He Adds. Warning of Urban-Rural Break, Iowan Declares, "Public Won't Know Until It Happens."

May 5, 1933. NATIONAL STRIKE OF FARMERS VOTED. Holiday Association Issues Call at Des Moines for Tie-Up May 13. Mobbed Judge at Hearing. Bradley Tells Iowa Military Court at Lemars of Riot Which Led to Martial Law.

May 7, 1933. SEE FARMERS COOL TO STRIKE APPEAL. O'Neal Observers in Survey by States Find Little Support except in Few Areas. South Held Unaffected. And Iowa Is Reported Shifting as Good Weather Comes Back.

May 13, 1933. DEFER FARM STRIKE ON ROOSEVELT PLEA. Holiday Leaders Decide at St. Paul to Delay Plans until New Program Is Tried. Olson Request a Factor. Minnesota Governor Asks Backing for the President—Wisconsin Milk Group to Go Ahead.

October 20, 1933. FARM STRIKE SET TOMORROW NOON. Holiday Group, Chiefs of Five States, Meeting in St. Paul, Issue National Call. For Forcing an NRA Code. Neglect of Rural America Is Charged—Move Is Rebuffed in Ohio and Indiana.

October 21, 1933. FARM STRIKE TODAY; MORE STATES JOIN. Leaders at Omaha Meeting Appeal to Business Men for Support. Governors Favor Move but South Dakota Executive Attacks Bryan for Not Following Roosevelt.

October 22, 1933. FARM STRIKE CHIEF ASKS LABOR'S AID. Reno Opens "Non-Buying, Non-Selling Holiday" with Bid for Nation-Wide Backing. Fight for "Independence." Extent of Response Uncertain—Govs. Bryan and Olson Indicate Their Sympathy.

October 23, 1933. 75 PICKETS BLOCK IOWA FARM TRUCKS. Produce Men Turn Back near James with Food Bound for Sioux City. Reno Claims Labor's Aid. Strike Chief to Go to Chicago to Talk to A. F. Whitney, Trainmen's Chief.

October 25, 1933. FARM STRIKE FAILS TO HALT FOODSTUFFS. Sporadic Picketing Activity Is Reported in Iowa and Central Wisconsin.

October 26, 1933. CALLS 9 GOVERNORS FOR FARM PARLEY. Herring of Iowa Also Asks that Roosevelt Send Morgenthau to Conference. Mid-West Markets Normal. Holiday Group Strike Is Pursued Actively in Iowa, Minnesota and Wisconsin Only.

October 29, 1933. FARMERS' STRIKE WOBBLES AT START. Impression of First Week of the "Holiday" Is One of Ineffectiveness. Crops Going to Market. Small, Zealous Group Follows Tub-Thumping Leaders but Majority Takes No Part.

October 30, 1933. FARM STRIKE FAILS TO STOP MARKETING. Grains, Milk, Produce and Livestock are Moved in Nearly Full Volume.

October 31, 1933. FARMERS PRESENT PLEA TO GOVERNORS. Moratoria on Mortgages and Currency Expansion Advocated at Des Moines. Strikers Ask Embargo. Wisconsin Milk Pool Joins the National Walkout—Leader Warns against Violence.

November 1, 1933. 5 GOVERNORS ASK CODE FOR FARMERS. Representatives of 4 Others Join in Plea to Roosevelt—Inflation Is Demanded. Pegged Prices Sought. Mid-West Executives Praise the President—Farm Strike Ends in Wisconsin.

November 2, 1933. FARM PLEA TAKEN DIRECT TO CAPITAL. Mid-Western Governors Arrive to See Roosevelt on Code and Price Demands. Reno "Suspends" Strike but Two Wisconsin Creameries Are Bombed and Minnesota Group Votes Tie-Up.

November 5, 1933. PUTS FARM STRIKE INTO "FULL GEAR." Reno Orders Intensification in 21 States after Plea of the Governors Fails. Oklahoma Group Joins. Murray Urges Vote "Revolution" unless Congress Acts—Wisconsin Fight Is Renewed.

November 5, 1933. FARM STRIKE DIES AS GOVERNORS MEET. Mid-West Executives Endorse Reno Program as It Collapses. Pass It to President. Pickets Are Called Off and Revolt Is Forgotten for Corn-Husking Contest.

November 7, 1933. FARM PICKETS FIRE IOWA RAIL BRIDGE, SHOOT INTO TRAIN. Failing to Stop Freight at Span Near Sioux City, They Burn Structure. Appeal Made for Troops. Blockade Halts Cattle Trucking—Governors to Present Farm Demands to Congress. Wallace Asks Fair Trial. Recovery Plan Will Help Farmer, He Says on the Radio—AAA Liberalizing Corn Loans.

November 8, 1933. FARMERS' STRIKE CHECKED BY COLD. Roving Bands of Opponents Find No Iowa Pickets Out in Subzero Weather. Troop Call Is Refused. Governor Tells Sheriffs to Deputize Citizens—Guards Are Posted by Railroads.

November 9, 1933. FARM FEDERATION OPPOSES STRIKE. E. A. O'Neal, Calling on Roosevelt, Backs the AAA Program as Hopeful. More Cash Is Forecast. Wallace Aide Says That Rural Income Will Prove 20% above That of Year Ago.

November 15, 1933. "REVOLUTION" IDEA NOT IN IOWA MIND. Farmers Are Desperate and Unhappy, but Are Taking Adversity Calmly. Minority on the Warpath. Corn Yield Crams Granaries and 90 Per Cent of Growers Will Sign Federal Pact.

November 16, 1933. FARM DISCONTENT NOT OVER ALL IOWA. Even Most Militant Section Is Not Unanimous, Except in Distrust of Corn-Hog Plan.

November 17, 1933. FARM STRIKE FADES BEFORE CROP LOANS. Reno Loses His Hold in Iowa as Other Leaders Urge Accepting Federal Fund. Militant Editor Quits. Lemars Newspaper Advises the Farmers to Try Wallace Plan and Get on Their Feet Again.

November 19, 1933. WISCONSIN FARM STRIKE TRUCE.

November 19, 1933. RADICALISM WANES IN CORN BELT AREA. Wallace Speech Does Much to Counteract Influence of Strike Leaders. Much Depends on Speed. Prompt Action on Loans and Corn-Hog Agreements Would Scotch Reno Efforts.

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A FARM POLICY

D. GALE JOHNSON

A PROGRAM THAT ACHIEVES higher income for farm families and increased price and income stability cannot consist solely of measures directly affecting market prices. The existing farm program is weak mainly because so much effort is expended in influencing the prices farmers receive for their products. More than anything else the price system represents a registering and directing mechanism. Consequently, to establish prices as goals and to achieve those goals by actions affecting market prices results in distortions, inefficiencies, and probably failure to improve the lot of farm people significantly.

Notwithstanding the above, it is necessary to have a positive price policy. Farm price instability is a real curse in terms of its effects upon both efficiency in production and the welfare of farm people. Farm prices have failed to serve as adequate guides to farmers in making their production plans. The volatility in their general level has brought recurring periods of prosperity and hardship to farm people. Farm prices and incomes have tended to fluctuate much more than the incomes and prices of other large groups in our society.

Over a long period of time, however, the welfare of farm people is not very closely associated with the level of farm prices. It depends

upon the level of farm family incomes. Farm family incomes need not move directly in parallel to prices received. Changes in output per worker, the number of workers per family, and the level of nonlabor costs of production, as well as shifts in products produced, can and do mean that very different levels of farm family incomes are associated with the same general level of prices.

If we are politically realistic, it is obvious that the existing breach between farm and trade policies will not be closed by returning to a completely free market situation in agriculture. It is quite evident that the particular framework within which an agricultural policy is to evolve is not one permitting a *laissez faire* approach. Income transfers and subsidies to agriculture will continue. The burden of this discussion has been that the manner in which the income transfers are made is more significant than the total amounts involved. Consequently, it is necessary that fairly specific guides be set forth that would govern income transference and subsidization. General agreement upon such guides would go a long way toward codifying opinion concerning a desirable long-range farm policy.

Two general guides for income transference which would lead to efficient utilization of agricultural resources and a minimization of inconsistency with freer flow of goods are as follows:

1. Income transfers should not be made through direct market-price-raising measures, such as support prices, commodity, loans, production control, price discrimination, export subsidies, and dumping.

2. Income transfers should be used chiefly in four circumstances:

(a) To mitigate economic distress arising out of the absolute and differential impacts of depression.

(b) To aid in adjustments in the supply of labor and other resources in areas where farming provides a low level of farm family income.

(c) To improve the efficiency with which land resources are utilized and to maintain soil productivity at a desirable level.

(d) As an incidental adjunct of measures to increase price certainty and stability.

If these criteria are followed, agriculture as a whole will stand on its own feet except when the entire economy is functioning poorly in a cyclical sense. In this instance, payments to agriculture are advisable as a means of relieving distress in agriculture as a part of a general attack upon the depression itself. Certain segments—the sick parts—would receive aid in reaching suitable resource adjustments. To eschew subsidies and aids in these circumstances is nothing less than sheer nonsense. A well-conceived conversion program, as it might be called,

could result in a long-run and relatively permanent improvement in utilization of resources in the given area.

The specific agricultural programs that the author advocates as worthy of study are the following:

1. A national food and fiber program to expand and stabilize the demand for agricultural products. This program could consist of measures to create new outlets for farm products, to promote the efficiency with which agricultural products are marketed, and to increase and stabilize the demand for farm food products by a nutrition program designed to insure all citizens an adequate diet.

2. A system of compensatory price or income payments to protect farmers from the impacts of depression upon prices and income and to compensate farmers for the maintenance of production during depression periods. This specific program would be secondary to a general monetary-fiscal policy to prevent depressions and would be an integral part of a monetary-fiscal policy to re-establish prosperity if a depression has commenced. The payments involved should not significantly discriminate in favor of agriculture as compared to other sectors of the economy.

3. A system of forward prices to aid farmers in making their production plans during periods of full employment. The forward prices would represent advance estimates of the anticipated levels of prices which would prevail. The techniques for meeting the commitments involved should be such as to have little or no direct market-price effects.

4. A storage program to reduce the impact of weather fluctuations upon the supplies of livestock and crop products available to consumers and to reduce somewhat the repercussions upon farm prices and incomes.

5. A conversion program for any area in which the supply of labor is in excess and the level of labor returns per person or family is seriously below that of other sectors of agriculture or the rest of the economy. Such a program is required to ease the inevitable transition period before the supply of labor has been sufficiently reduced to permit the desired increase in labor income.

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OIL AND THE FARMER

MOST AMERICANS take for granted the high standard of living they enjoy—a standard that stems in part, at least, from mechanization of farms and industry. Imagine, though, what our farm situation would be if overnight we had to substitute horses, mules, oxen and manpower for the tractors, trucks and other machinery so widely used on the nation's farms. How many more bushels of grain would we have to grow just to feed those working animals? How many millions of people, now producing countless goods which give us our high standard of living, would be required on farms to grow our food? Viewed in this light, it is easy to appreciate how essential farm mechanization is to all of us.

The "hay-burner" has given way to the oil burner on American farms. Or, more specifically, horses and mules have been replaced by tractors, trucks and specialized machinery on hundreds of thousands of farms throughout the United States.

From this increasing mechanization of farm work comes a happy paradox: The American farmer finds his work easier, has more leisure, yet produces almost 50 per cent more than he did 15 years ago.

Momentous as it is to the farmer in relieving the drudgery and shortening the hours of his work, farm mechanization has proved fully as significant to all Americans, for it has helped raise their standard of living. This it has done by releasing from the soil manpower to augment the nation's industrial power—power that means more automobiles, washing machines, radios, vacuum cleaners and all the other things that add up to a higher standard of living. Moreover, thanks to the supplanting of horses with horsepower, great areas once devoted to feeding work animals are now used to grow food for human consumption.

Synchronized with this upsurge in farm mechanization has been a growing interdependence between agriculture and the petroleum industry. The farmer today depends upon petroleum products more than ever before. Agriculture's principal petroleum needs are for the fuels and lubricants for the nation's three and a half million farm tractors, nearly two and a half million farm trucks (one-third of all trucks in the United States), and more than five and a half million automobiles on farms.

Agriculture has other petroleum needs besides power and lubrication for its motorized equipment. The farmer uses liquid petroleum gas and kerosene for heating and cooking. He requires insecticides, weed killers, fungicides, and fertilizers—products made from petroleum or employing petroleum as bases and carrier. And, thanks to research, he has available many new petroleum products that perform such varied jobs as preventing the falling of apples, hastening the ripening of fruit, and increasing crop yields.

With the spread of farm mechanization, the oil industry has become increasingly aware of the farm market and has directed much effort toward meeting the farmer's requirements. Consequently, the industry today is geared to meet agriculture's demands quickly and effectively in all parts of the country. It does so, not only by supplying the many products needed, but also by helping to train farm workers in the operation and care of the equipment in which petroleum products are used.

When he selects fuel or lubricant for his tractor, the modern farmer, if he is to run his farm efficiently, must use as much care as when he chooses seeds and fertilizers. And, conversely, the dealer in petroleum products must know a great deal about farming and must have good understanding of the farmer's problems if he hopes fully to meet the farmer's needs. These are extensive: One source estimates that American farmers use more than ten billion gallons of oil products yearly. Large as it is, this figure is far from its peak, for agriculture's "Industrial Revolution" is just hitting its stride. Even though the horse and mule population has fallen far below its 1920 total of over 25 million, more than eight million of these work animals still toil on American farms.

Of all the many types of mechanized equipment used in farming, none is more useful to the farmer—or more dependent upon the oil industry—than the modern tractor. This versatile instrument, with its power take-off, hydraulic attachments, lights, starter and high speed, powers at least 100 different tools, from the plow that it drags across a field to complicated machines deriving their power from the tractor's

take-off shaft. The latter machines include combines, corn-pickers and cotton-pickers, as well as scores of other implements such as pumps, saws, scoops, rakes, lifts, bull-dozers and even post-hole diggers.

The tractor has revolutionized the farmer's life. A Missouri wheat grower says:

"The tractor is the key to farming more land quicker and better. If the oil industry should ever shut down, all the farmers I know would be out of business within two weeks." A Kansas wheat farmer declares: "I work 400 acres alone, thanks chiefly to my tractor. With the old-fashioned methods I'd need three or four men all the year around and 16 or 18 for harvest time."

During 1948, according to the U. S. Department of Agriculture, farm tractors consumed more than three billion gallons of fuel (1,000 gallons per tractor), and used 75 million gallons of motor oils (23 gallons for each tractor).

In the Great Plains area—heart of the nation's wheat, corn and livestock production—among the sprawling ranches of the Southwest, and in other areas of "big-time" farming, the Flying Red Horse Companies' dealers and commissioned agents, many of them farmers once themselves, are tuned to the farmer's needs. In such areas, Company-sponsored "farm meetings" have become almost an institution. These meetings, educational in character, have given farmers much information on the proper use and care of machinery. For example, the generally-accepted practice of changing gear oil seasonally to eliminate dirt and metal particles from tractor gear cases was first recommended at a farm meeting.

Wherever American soil is tilled, the farm mechanization story is the same—greater and greater reliance upon specialization, mass-production methods and labor-saving machinery. The potato farmer in Maine, the cotton planter in Mississippi, the rancher in Texas and the orange grower in California depend alike upon their respective oil suppliers for sound advice on fuel and lubrication. Like most American farmers, they have come to expect from the oil industry the same kind of quality, service, and intelligent counsel that oil companies provide for large industrial plants.

Through mechanization, many of today's farmers are, in a sense, factory managers. Though inclined to be "from Missouri," they are progressive and willing to lend an attentive ear to those whose advice has proved forthright and sound. They have found it worth while to use the help of the several groups ready to serve them—trained representatives of oil companies, farm bureaus and state agricultural schools.

They also utilize thoroughly the farm publications which bring them information on practical farming.

The type, rather than the size, of a farm determines the extent of its mechanization. For example, cattle, dairy and fruit farms are among the least mechanized, since handling livestock and picking fruits call for better judgment and care than have yet been built into a machine. But even on a dairy farm there is a degree of mechanization that would have seemed fantastic not many years ago. And the mechanization of regular crop farming is even more advanced. A large proportion of the mechanical equipment goes to handle the nation's three largest crops. These are the food grains (wheat, rice, rye and buckwheat); the feed grains (corn, oats, barley and sorghums); and hay. Together, these crops cover more than four-fifths of the nation's harvested acreage.

Farm mechanization has had other results beyond increasing efficiency and output. With mechanization has come greater application of business and scientific methods to farming. This has brought into farming college- and agricultural-school-trained young men well versed in the operation of the latest mechanical equipment, in soil conservation and in many other new farm techniques.

The sweeping changes wrought by mechanization have been seen lately in the cotton fields where tractors and big self-propelled mechanical cotton pickers have released thousands of field workers for employment in factories throughout the country. The mechanical cotton pickers gather as much cotton in a day as can 40 or 50 human pickers.

While such mechanical marvels as the cotton pickers, the giant combines of the Midwest, and the sturdy tractors in all parts of the country brought new efficiency to farm operations, the automobile and truck made their contribution also. For one thing, the motorcar ended the forced provincialism of the farm population. Today's farmer and his family make more trips to town and take a more active part in community life. Motor trucks have a wide range of farm uses—in the fields for transporting seed, tools, fertilizers and other necessities, and on the highways for carrying a large share of the country's crops and livestock to market. The airplane, too, is finding wide acceptance on farms, not only for seeding and spraying, but for all-around transportation as well. Today there are more than 9,000 aircraft on the nation's farms compared with only 100 in 1941.

Farm efficiency and productivity will continue to rise as mechanization becomes more widespread and science discovers new products and new methods for agriculture. Meanwhile, the petroleum industry

will provide the many oil products the farmer needs and, through research, will develop new products for agriculture.

By improving the farmer's lot, increasing his output and providing more food at lower cost, the competitive enterprise system—seen here in mechanized farming—has proved as workable on the farms of America as in the nation's business and industrial life. It has put to flight such fears as those voiced more than a century and a half ago by Thomas Malthus, the Englishman who foresaw a world of misery and hunger because man could not produce enough food to match his population growth. More food for more people appears a far more reasonable prediction today.

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MUNN v. ILLINOIS, 1876

MR. CHIEF JUSTICE WAITE delivered the opinion of the court.

The question to be determined in this case is whether the general assembly of Illinois can, under the limitations upon the legislative powers of the State imposed by the Constitution of the United States, fix by law the maximum of charges for the storage of grain in warehouses ... "in which grain is stored in bulk, and in which the grain of different owners is mixed together, or in which grain is stored in such a manner that the identity of different lots or parcels cannot be accurately preserved."

* * * *

When the people of the United Colonies separated from Great

Britain, they changed the form, but not the substance, of their government. They retained for the purposes of government all the powers of the British Parliament, and through their State constitutions, or other forms of social compact, undertook to give practical effect to such as they deemed necessary for the common good and the security of life and property. All the powers which they retained they committed to their respective States, unless in express terms or by implications reserved to themselves. Subsequently, when it was found necessary to establish a national government for national purposes, a part of the powers of the States and of the people of the States was granted to the United States and the people of the United States. This grant operated as a further limitation upon the powers of the States, so that now the governments of the States possess all the powers of the Parliament of England, except such as have been delegated to the United States or reserved by the people. The reservations by the people are shown in the prohibitions of the constitutions.

* * * *

Under these powers the government regulates the conduct of its citizens one towards another, and the manner in which each shall use his own property, when such regulation becomes necessary for the public good. In their exercise it has been customary in England from time immemorial, and in this country from its first colonization, to regulate ferries, common carriers, hackmen, bakers, millers, wharfingers, innkeepers, etc., and in so doing to fix a maximum of charge to be made for services rendered, accommodations furnished, and articles sold. To this day, statutes are to be found in many of the States upon some or all these subjects; and we think it has never yet been successfully contended that such legislation came within any of the constitutional prohibitions against interference with private property.

* * * *

This brings us to inquire as to the principles upon which this power of regulation rests, in order that we may determine what is within and what is without its operative effect. Looking, then, to the common law, from whence came the right which the Constitution protects, we find that when private property is "affected with a public interest, it ceases to be *juris privati* only." This was said by Lord Chief Justice Hale more than two hundred years ago . . . and has been accepted without objection as an essential element in the law of property ever since. Property does become clothed with a public interest when used in a manner to make it of public consequence, and

affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control. . . .

From the same source comes the power to regulate the charges of common carriers. . . .

* * * *

Common carriers exercise a sort of public office, and have duties to perform in which the public is interested. . . . Their business is, therefore, "affected with a public interest," within the meaning of the doctrine which Lord Hale has so forcibly stated.

But we need not go further. Enough has already been said to show that, when private property is devoted to a public use, it is subject to public regulation. It remains only to ascertain whether the warehouses of these plaintiffs in error, and the business which is carried on there, come within the operation of this principle.

For this purpose we accept as true the statements of fact contained in the elaborate brief of one of the counsel of the plaintiffs in error. . . . The quantity [of grain] received in Chicago has made it the greatest grain market in the world. This business has created a demand for means by which the immense quantity of grain can be handled or stored, and these have been found in grain warehouses, which are commonly called elevators, because the grain is elevated from the boat or car, by machinery operated by steam, into the bins prepared for its reception, and elevated from the bins, by a like process, into the vessel or car which is to carry it on. . . .

* * * *

"The railways have found it impracticable to own such elevators, and public policy forbids the transaction of such business by the carrier; the ownership has, therefore, been by private individuals, who have embarked their capital and devoted their industry to such business as a private pursuit."

In this connection it must also be borne in mind that, although in 1874 there were in Chicago fourteen warehouses adapted to this particular business, and owned by about thirty persons, nine business firms controlled them, and that the prices charged and received for storage were such "as have been from year to year agreed upon and established by the different elevators or warehouses in the city of

Chicago, and which rates have been annually published in one or more newspapers printed in said city, in the month of January in each year, as the established rates for the year then next ensuing such publication." Thus it is apparent that all the elevating facilities through which these vast productions "of seven or eight great States of the West" must pass on the way "to four or five of the States on the sea-shore" may be a "virtual" monopoly.

Under such circumstances it is difficult to see why, if the common carrier, or the miller, or the ferryman, or the innkeeper, or the wharfinger, or the baker, or the cartman, or the hackney-coachman, pursues a public employment and exercises "a sort of public office," these plaintiffs in error do not. They stand, to use again the language of their counsel, in the very "gateway of commerce," and take toll from all who pass. Their business most certainly "tends to a common charge, and is become a thing of public interest and use." Every bushel of grain for its passage "pays a toll, which is a common charge," and, therefore, according to Lord Hale, every such warehouseman "ought to be under public regulation, viz., that he . . . take but reasonable toll." Certainly, if any business can be clothed "with a public interest and cease to be *juris privati* only," this has been. It may not be made so by the operation of the Constitution of Illinois or this statute, but it is by the facts.

We also are not permitted to overlook the fact that, for some reason, the people of Illinois, when they revised their Constitution in 1870, saw fit to make it the duty of the general assembly to pass laws "for the protection of producers, shippers, and receivers of grain and produce," . . . and to require all railroad companies receiving and transporting grain in bulk or otherwise to deliver the same at any elevator to which it might be consigned, that could be reached by any track that was or could be used by such company, and that all railroad companies should permit connections to be made with their tracks, so that any public warehouse, etc., might be reached by the cars on their railroads. This indicates very clearly that during the twenty years in which this peculiar business has been assuming its present "immense proportions," something had occurred which led the whole body of the people to suppose that remedies such as are usually employed to prevent abuses by virtual monopolies might not be inappropriate here. . . .

Neither is it a matter of any moment that no precedent can be found for a statute precisely like this. It is conceded that the business is one of recent origin, that its growth has been rapid, and that it is

already of great importance. And it must also be conceded that it is a business in which the whole public has a direct and positive interest. It presents, therefore, a case for the application of a long-known and well-established principle in social science, and this statute simply extends the law so as to meet this new development of commercial progress. There is no attempt to compel these owners to grant the public an interest in their property, but to declare their obligations, if they use it in this particular manner.

It matters not in this case that these plaintiffs in error had built their warehouses and established their business before the regulations complained of were adopted. What they did was from the beginning subject to the power of the body politic to require them to conform to such regulations as might be established by the proper authorities for the common good. They entered upon their business and provided themselves with the means to carry it on subject to this condition. If they did not wish to submit themselves to such interference, they should not have clothed the public with an interest in their concerns. The same principle applies to them that does to the proprietor of a hackney-carriage, and as to him it has never been supposed that he was exempt from regulating statutes or ordinances because he had purchased his horses and carriage and established his business before the statute or the ordinance was adopted. . . .

We come now to consider the effect upon this statute of the power of Congress to regulate commerce.

It was very properly said in the case of the State Tax on Railway Gross Receipts . . . that "it is not everything that affects commerce that amounts to a regulation of it, within the meaning of the Constitution." The warehouses of these plaintiffs in error are situated and their business carried on exclusively within the limits of the State of Illinois. They are used as instruments by those engaged in interstate commerce, but they are no more necessarily a part of commerce itself than the dray or the cart by which, but for them, grain would be transferred from one railroad station to another. Incidentally they may become connected with interstate commerce, but not necessarily so. Their regulation is a thing of domestic concern, and, certainly, until Congress acts in reference to their interstate relations, the State may exercise all the powers of government over them, even though in so doing it may indirectly operate upon commerce outside its immediate jurisdiction. We do not say that a case may not arise in which it will be found that a State, under the form of regulating its own affairs, has encroached upon the exclusive domain of Congress,

in respect to interstate commerce, but we do say that, upon the facts as they are represented to us in this record, that has not been done. . . .

Judgment affirmed.

MR. JUSTICE FIELD AND MR. JUSTICE STRONG dissented. . . .

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SMYTH v. AMES

[IN 1893 THE LEGISLATURE OF NEBRASKA enacted a law, . . . fixing the maximum rates to be charged by railways for the carriage of freight between points in Nebraska. Ames, a citizen of Massachusetts and stockholder in one of the railways concerned, and other persons similarly situated brought suit in the United States Circuit Court against the railways and the officers and members of the Board of Transportation of Nebraska to enjoin the publication of schedules which would reduce the rates to the scale prescribed in the act. Injunctions having been granted, the Board of Transportation and its officers appealed.]

MR. JUSTICE HARLAN delivered . . . the opinion of the court. . . .

We are now to inquire whether the Nebraska statute is repugnant to the Constitution of the United States.

By the Fourteenth Amendment it is provided that no State shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws. . . . What amounts to deprivation of property without due process of law or what is a denial of the equal protection of the laws is often difficult to determine, especially where the question relates to the prop-

erty of the *quasi*-public corporation and the extent to which it may be subjected to public control. . . .

In view of the adjudications these principles must be regarded as settled.

1. A railroad corporation is a person within the meaning of the Fourteenth Amendment declaring that no State shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

2. A state enactment, or regulations made under the authority of a state enactment, establishing rates for the transportation of persons or property by railroad that will not admit of the carrier earning such compensation as under all circumstances is just to it and to the public, would deprive such carrier of its property without due process of law and deny to it the equal protection of the laws, and would therefore be repugnant to the Fourteenth Amendment of the Constitution of the United States.

3. While rates for the transportation of persons and property within the limits of a State are primarily for its determination, the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the Constitution secures, and therefore without due process of law, cannot be so conclusively determined by the legislature of the State or by regulations adopted under its authority, that the matter may not become the subject of judicial inquiry.

The cases before us directly present the important question last stated.

Before entering upon its examination, it may be observed that the grant to the legislature in the Constitution of Nebraska of the power to establish maximum rates for the transportation of passengers and freight on railroads, in that State has reference to "reasonable" maximum rates. These words strongly imply that it was not intended to give a power to fix maximum rates without regard to their reasonableness. Be this as it may, it cannot be admitted that the power granted may be exerted in derogation of rights secured by the Constitution of the United States, or that the judiciary may not, when its jurisdiction is properly invoked, protect those rights. . . .

We turn now to the evidence in the voluminous record before us for the purpose of ascertaining whether—looking at the cases in the light of the facts as they existed when the decrees were rendered—the Nebraska statute, if enforced, would, by its necessary operation, have deprived the companies, whose stockholders and bondholders

here complain, of the right to obtain just compensation for the services rendered by them. . . .

The first and most important contention of the plaintiffs is that, if the statute had been in force during any one of the three years preceding its passage, the defendant companies would have been compelled to use their property for the public substantially without reward or without the just compensation to which it was entitled. We think this mode of calculation for ascertaining the probable effect of the Nebraska statute upon the railroad companies in question is one that may be properly used. . . .

The reasonableness or unreasonableness of rates prescribed by a State for the transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it. The State cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business, over which, so far as rates are concerned, the State has no control. . . . The argument that a railroad line is an entirety; that its income goes into, and its expenses are provided for, out of a common fund; and that its capitalization is on its entire line, within and without the State, can have no application where the State is without authority over rates on the entire line, and can only deal with local rates and make such regulations as are necessary to give just compensation on local business. . . .

The plaintiffs contended that a railroad company is entitled to exact such charges for transportation as will enable it, at all times, not only to pay operating expenses, but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock; and that to prohibit it from maintaining rates or charges for transportation adequate to all those ends will deprive it of its property without due process of law, and deny to it equal protection of the laws. . . .

The broad proposition advanced by counsel involves some misconception of the relations between the public and a railroad corporation. It is unsound in that it practically excludes from consideration the fair value of the property used, omits altogether any consideration of the right of the public to be exempt from unreasonable exactions, and makes the interests of the corporation maintaining a public highway the sole test in determining whether the rates established by or for it are such as may be rightfully prescribed as between it and the public. A railroad is a public highway, and none the less so because constructed

and maintained through the agency of a corporation deriving its existence and powers from the State. Such a corporation was created for public purposes. It performs a function of the State. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. It is under governmental control though such control must be exercised with due regard to the constitutional guarantees for the protection of its property. . . .

If a railroad corporation has bonded its property for an amount that exceeds its fair value, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates, as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds, and obligations, is not alone to be considered when determining the rates that may be reasonably charged. . . .

The basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. But even upon this basis, and determining the probable effect of the act of 1893 by ascertaining what could have been its effect if it had been in operation during the three years immediately preceding its passage, we perceive no ground on the record for reversing the decree of the Circuit Court. On the contrary, we are of opinion that as to most of the companies in question there would have been, under such rates as were established by the act of 1893, an actual loss in each of the years ending June 30, 1891, 1892, and 1893; and that, in the exceptional cases above stated, when two of the companies would have earned something above operating expenses, in particular

years, the receipts or gains, above operating expenses, would have been too small to affect the general conclusion that the act, if enforced, would have deprived each of the railroad companies involved in these suits of the just compensation secured to them by the Constitution. Under the evidence there is no ground for saying that the operating expenses of any of the companies were greater than necessary. . . .

The decree in each case must be affirmed.

THE CHIEF JUSTICE took no part in the consideration or decision of these cases.

MR. JUSTICE MCKENNA was not a member of the court when they were argued and submitted, and took no part in their decision.

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NEEDS vs. RESOURCES

J. FREDERIC DEWHURST AND OTHERS

THE HUMAN AND MATERIAL RESOURCES at our command, together with the requisite technical knowledge and administrative skill to use them effectively, are the fundamental elements in our capacity as a nation to provide the goods and services we require. That there is nothing automatic and inevitable in the functioning of these basic resources is clear from our experience during the worst years of the Great Depression, when national output fell to less than half of what we were capable of producing and consuming. That the normal capacity of our economy to provide needed goods and services can be radically modified and rapidly expanded is clear from our experience during World War II.

1. WAR OUTPUT AND DEFERRED DEMAND

The war furnished dramatic evidence of our ability to transfer labor and resources from one use to another, to convert facilities to new and different productive ends and to call forth potential and idle resources and thus greatly expand total productive capacity. When the defense program began in 1940, there was much slack in the economy. We had a good deal of idle plant capacity, and about one seventh of our normal labor force was out of work. But, as war production gained momentum and military forces expanded, we soon absorbed idle manpower and facilities and began to draw on our human and material reserves. Two years after the defense program got under way unemployment had dropped to less than a normal peacetime level, more than 2 million emergency workers had been drawn into the labor force, conversion of peacetime facilities useful in war production was virtually complete and the bulk of the vast wartime addition to our industrial capacity was in operation.

THE WAR POTENTIAL

By the winter of 1944–45 we had achieved our war potential with an average of 63 million at work in civilian and military occupations, compared with 47 million in 1940. There were 12 million in military service, 7 million emergency workers in the labor force, and unemployment was close to the vanishing point. In the peak year of the war effort gross national product was more than twice as large as in fairly prosperous 1940—almost $200 billion compared with less than $100 billion. Allowing for a rise in prices and costs of nearly one third during this four-year period, we turned out 50 to 60 per cent more goods and services in 1944 than in 1940.

This, in bare statistical detail, was the "miracle of war production" that enabled the United States to become the "arsenal of democracy" for half the world while maintaining home civilian consumption close to the highest peacetime levels. What this magnificent wartime accomplishment means in terms of our capacity to meet future peacetime needs is difficult to answer, but easy to exaggerate. Certainly, it is a tribute to American technical ingenuity and organizing genius in both the military and the industrial spheres; to the health, energy, intelligence and skill of American workers and soldiers; and to the willingness of American consumers to accept the inconveniences and sacrifices essential in fighting a war.

The war experience also proved that we can greatly alter and expand our capacity to produce, given time and sufficiently powerful

pressures and incentives. But it did not demonstrate that our productive capacity is "unlimited," that we have achieved a push-button utopia which turns out goods without human effort, that we have "solved the problem of production," whatever that expression may mean, or even that we are likely to be able to produce in peacetime at anything like the wartime rate without great increases in output per man-hour.

On the contrary, the doubling of our dollar volume of output during the defense and war period can be accounted for almost entirely by higher prices, more workers and longer working hours. Of the total increase of almost $102 billion in gross national product between 1940 and 1944, at least $31 billion reflected higher prices, while nearly $45 billion came from the expansion of our working force by more than a third and $15 billion from longer working hours. The remaining $11 billion could be accounted for by an average increase of less than 1.5 per cent in output per man-hour for the economy as a whole during the four-year period—much less than the annual increase in productivity during the two immediate prewar decades. However, if, as seems possible, the assumed average price increase of 32 per cent between 1940 and 1944 understates the actual rise in prices and costs, there may have been no increase—or an actual decrease—in over-all productivity during the war years.

Whatever may be the many favorable effects of wartime technological developments on future productivity, they were not evident in the immediate postwar period. Indeed, although the engineering phases of reconversion were completed promptly after the end of the war, it soon became clear that the effective capacity of our peacetime economy was being taxed beyond its limits in supplying the abnormally large demand for goods. Certainly, this gap between productive capacity and immediate demand was still evident more than a year after V-J Day—in spite of abnormally large employment. This inability to meet immediate postwar needs appears to have been due on the one hand to our failure to achieve substantial gains over (or even to maintain) pre-war productivity, and on the other to the fact that the normal demand accompanying high income levels was augmented by a great backlog of demand for goods not available during the war.

GUNS AND BUTTER?

During the period of peak war production it was commonly said that the United States, alone among the great belligerent nations, was able to have "both guns and butter." In a limited statistical sense

this was true. Our vast production of war material and our far-flung military activities were "superimposed" upon a volume of civilian consumption that continued at or above the levels of our most prosperous prewar year. Consumers spent $75 billion for goods and services in 1941 and $99 billion in 1944. Allowing for a 25 per cent price rise, we actually consumed more at the peak of the war effort—with half our total production going to government, largely for war purposes—than in prosperous 1941. But in spite of this well-maintained volume of civilian consumption (which further rapidly expanded after V-J Day), the American people were still faced with a wide range of acute shortages more than a year after the end of the war.

The explanation of this apparent anomaly lies in the distorted pattern of wartime consumption. Although we spent much more money during the war than in prewar years, and were able to produce and consume as much civilian goods, consumer choice was severely limited. Household appliances and many other consumers' durables rapidly disappeared from the market after 1941, and a year later many textile and other products did also. Inasmuch as we could not buy automobiles, refrigerators, vacuum cleaners, radios and other things we wanted and could readily afford with war-swollen incomes, we spent our money for what we could get. This meant that in spite of a statistically large volume of civilian consumption during the war, we piled up an enormous backlog of deferred demand for the things we had been unable to buy.

* * * *

BACKLOG DEMAND

At a minimum, the war-deferred demand for consumers' goods alone—chiefly for automobiles, household mechanical appliances and furniture—probably amounted to $25 billion at the end of 1945. To this must be added heavy accumulated requirements for a wide range of capital goods, such as housing, productive facilities and road construction. In spite of the vast war construction program, our investment during the five-year defense and war period of $49 billion in *capital goods usable in peacetime* was $37 billion less than we spent for the same purposes during 1925–29. It was even $16 billion less than the subnormal 1935–39 outlays, after allowing for higher wartime construction costs. The total deferred requirements for consumption and capital goods at the end of the war, therefore, can hardly have been less than $40 billion and may have been as much as $60 billion.

Spread over the transition period to the end of the present decade, this backlog demand means an *excess* of $10 billion or more per year over the normal demand to be expected with high levels of activity. In some ways—though with important differences and on a smaller scale—the situation confronting the American economy at the end of the war was the same as when the war was declared. At that time we had a vast need for a wide range of war material, far beyond the immediate capacity of the economy to supply. Meeting these requirements took time, for it meant large-scale conversion of existing plant and equipment and construction of new facilities. But the existence of that demand guaranteed a high rate of activity and employment until the war's end. There was no danger then that cost-price distortions would cause that demand to evaporate. For one thing, labor and other costs were at least partially controlled. Still more important, the government stood ready with unlimited funds to buy what is needed. It was orders on the books that "made the wheels go round."

Again today, a potential demand for products we could not obtain during the war, as well as for other goods and services, exceeds our productive capacity. Today's demand, however, provides no guarantee of continuous "full employment" until it is satisfied. Despite the unparalleled accumulation of liquid funds in the hands of consumers and industry, the demand for products whose purchase can be further postponed will quickly evaporate if cost-price distortions result in pricing such goods "out of the market." This happened after World War I, with the result that we had a severe—though short—setback, long before the demand for housing and other war-deferred products had been met.

If we can avoid these distortions in costs and prices, however, the existence of this large backlog—especially for the products of the construction, machinery and equipment, and consumers' durable goods industries—can assure high levels of activity for some years to come, at least until the end of the present decade. During this period the productive capacity of many industries may well be taxed beyond normal limits of operation.

2. DEMAND AND OUTPUT IN 1950 AND 1960

[Note: This was written before the Korean situation.] Beyond this transitional "catching up" period, which this survey has assumed would end with the present decade, it is possible, with past experience as a guide, to estimate what the American people will produce, consume and invest in the future, under conditions of high-level

activity and employment. Such a projection of past trends and relationships to 1950 and 1960 is neither a forecast of actual production and consumption in those years nor of our maximum capacity to produce and consume, working under forced draft as in World War II. To attempt the first would be as foolhardy as trying in 1929 to forecast the level at which American economy would be operating in 1933 and in 1943. To attempt the second would have some practical utility, but only to indicate our maximum productive capacity in the dire event of a third world war.

These projections are merely attempts to show quantitatively what can be achieved with continuous high-level utilization of our resources and labor force. The projections for the 1950 decade are estimates of the volume of our gross national product and its composition—in terms of the major classes of consumption goods and services, capital goods and government services—under conditions approximating our "best performance" in the past, roughly comparable to the last half of the 1920's. This was a longer period of peacetime prosperity and full employment than we have enjoyed at any other time since the turn of the century.

What we will be able to produce and consume under comparable conditions in the 1950's will depend upon the number of people at work, the length of the work-week, and the average output per man-hour. Projection of past trends indicates that, with an estimated population of almost 145 million in 1950, the labor force will number 60 million—nearly 42 per cent of the population, or a larger ratio than in any prewar year. Past experience shows that even in good times unemployment averages about 5 per cent of the labor force, so that the average number of persons at work at high levels of activity in 1950 would be about 57 million, or 10 million more than in 1940. The long down-trend in working hours will probably continue, though perhaps at a slower pace than in the past. Hence the average work-week in 1950 may be a little less than 41 hours, compared with 43 hours in 1940. Under these conditions, the total "labor input" in 1950 would amount to 121 billion man-hours, or 15 per cent more than in 1940.

What this labor input would mean in terms of net and gross output—or national income and gross national product—depends upon labor productivity, or average output per man-hour. This, of course, is the great unknown in forecasting future production. Productivity has increased steadily for many decades, but the gains have varied widely from decade to decade. If we assume that the increase during the 1940 decade will be about 18 per cent, the average rate

during the nine decades since the middle of the nineteenth century, output per man-hour in 1950 will amount to \$1.16, in dollars of 1944 purchasing power. This would mean a national income of \$140 billion and a gross national product of \$177 billion.

Looking ten years further ahead, which is a more hazardous undertaking, this survey assumes a slightly smaller "participation in the labor force" than in 1950 and about the same as in 1940—approximately 41 per cent of the 155 million estimated 1960 population, or 63.4 million. With 5 per cent unemployment, there would be 60.2 million persons at work. On the assumption that the five-day week and annual vacations will have then become virtually universal, average working time would drop to a little under 38 hours per week. If over-all productivity again increases by 18 per cent during the decade, output per man-hour would reach about \$1.36, which would mean a national income of \$161 billion and a gross national product of \$202 billion.

How do these estimates of the goods and services we can produce and use in 1950 and 1960 compare with the past performance of our economic system? The estimated normal gross national product for 1950 would be about 10 per cent less than we produced at the peak of the war effort in 1944, and the 1960 gross output would be only slightly larger. In 1944, however, we were operating under the heavy pressures of a national emergency, with working hours abnormally long, virtually no unemployment, and with several million emergency workers in the labor market, most of whom withdrew soon after V-J Day.

Compared with prosperous 1941, however, and with earlier years of prosperity, a gross product of \$177 billion in 1950 and of \$202 billion in 1960 represents a handsome gain, not only in dollars but in "real" terms of goods and services available to the population. . . .

When allowance is made for price variations, it is interesting to note that this estimate of gross product for the fifth year after the end of World War II represents just twice the volume of goods produced by our economy in 1924, five years after World War I. With an estimated population growth of less than 30 per cent, this represents a striking gain in material welfare in a single generation. Compared with more recent years of prosperity, a 1950 gross product of \$177 billion would mean nearly one fifth more goods and services than in 1941, nearly 40 per cent more than in 1940 and almost two thirds more than we produced and consumed in 1929.

A 1960 gross product of \$202 billion, though involving a further gain of 14 per cent during the 1950 decade, compared with an esti-

mated population growth of 7 per cent, would mean a smaller rate of expansion of total output than in recent decades. But the assumptions of a slower growth of the labor force during the 1950 decade and a continued decline in working hours made in this survey are possibly too conservative.

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BASIC PROBLEMS OF WAR MOBILIZATION

CHARLES O. HARDY

To UNDERSTAND what is involved in wartime price control, it is necessary to consider its relation to the broad problem of mobilizing the nation's resources. Several questions present themselves in this preliminary consideration:

1. *What are the sinews of war?*

The answer is—shells, bombs, torpedoes, guns, tanks, airplanes, battleships, fortifications. To make these useful there must also be food, clothing, transportation, hospital service, and the like for the fighting forces. Back of the military organization are the fundamental factors for the production of war supplies—steel mills, shipyards, airplane factories, ammunition plants, industrial establishments, farms, and mines—and the laboring population, agricultural and industrial.

2. *By what means can the government obtain these sinews of war?*

The resources which the government needs for carrying on a war are obtainable in three ways only. The first is to take up the slack in the economic system—putting idle plants and idle men to work, running industrial establishments at maximum capacity, working

labor at maximum hours consistent with health and efficiency, increasing the output of farms and mines, making more efficient use of transportation facilities, reclaiming waste materials, and introducing production economies in general.

The second source is to shift production from non-essential peacetime commodities to essential wartime supplies—to turn out tanks or army trucks in place of pleasure cars, convert phonograph factories to the production of machine-gun parts, turn private chauffeurs into truck drivers, curtail passenger train service offered the public in order to release facilities for transportation of war materials, and so on.

The third is to import materials and supplies from foreign countries. These may consist either of commodities of which domestic production is negligible, such as tin, rubber, and manganese, or of commodities of which the national production is large but insufficient for war purposes, or even of commodities to replace domestic consumer goods and thus release resources for war use.

* * * *

4. *What part does money play in the mobilization of a nation's resources for war?*

It is obvious that money is not one of the direct implements of war; it cannot be hurled at the enemy. It is of use only in facilitating the process of acquiring the war materials and services which the government requires. The Congress may appropriate, and the Treasury of the United States may raise, billions of dollars; but these sums of money become effective only as they make possible the production of the essential war supplies. In one way only can money obtain results otherwise than through facilitating the production of war supplies, namely, in the purchase of essential imports.

5. *What is the significance of price in a war economy?*

To the extent that a government chooses to rely on the price system in organizing a war effort the function of price is the same as it is in a peace economy; that is, to attract human effort and material resources into those uses in which the demand for products is greatest and to determine the distribution of the national product among the various claimants—individuals, business organizations, governmental units—in accordance with the valuations placed by the community on their respective services.

In so far as the government obtains goods and services by purchase in the open market, the price operates to mobilize resources

for war effort by increasing the profits of those who produce what the government needs. The fact that through taxation and borrowing the government can utilize a virtually boundless stock of purchasing power would make it *possible* to carry through a war mobilization program with very little reliance on other controls. Indeed this is substantially what was done in all the wars in which this country engaged before the World War [I]. But such a procedure has led to violent price disturbances and distortions, with harmful—frequently disastrous—consequences both for the war effort and for the postwar business readjustment.

POSSIBLE SOURCES OF PRICE DISTORTION

The extensive and intensive mobilization of a nation's resources for war purposes naturally has a great impact upon the operation of the economic and financial system. We are here concerned with the way in which prices are disturbed in the absence of effective controls.

1. *What factors tend to create price disturbance in the initial stages of war?*

Among the factors which tend to create *initial* price advantages —at or even before the actual beginning of war—are the following:

(a) *Large government purchases on a competitive basis.* The Army and Navy Departments, assured of available funds, enter the markets and bid against private businesses and individuals for the limited supplies of war materials. During the early months of the World War [I] these departments, together with foreign allies, sometimes bid against one another for scarce products, the result of which was to run up prices far above the level that would have been necessary if the buying had been co-ordinated.

(b) *The expansion of business purchases.* The imminence or outbreak of war tends to cause business enterprises to increase greatly their current orders for inventories—in anticipation of possible shortages or to get ahead of expected price advances. Commitments may also be quickly made for an expansion of plant capacity, which involves additional purchases of materials.

(c) *Speculation in commodities.* The recollection of experiences in past wars and the threat of the curtailment of supplies of essential commodities, especially those which have to be imported from overseas, may stimulate an outburst of speculation. This may be either organized speculation through the exchanges, or unorganized speculation through the withholding of stocks of commodities from the market—by dealers or independent speculators. The advance buying

of inventories in anticipation of price increases, noted above, is also a form of speculation.

2. *What are the sources of price advances in subsequent stages of war mobilization?*

As the war mobilization program gains momentum, several factors have usually combined to stimulate price advances cumulatively. The most important are as follows:

(a) *Uncoordinated government buying.* Under the pressure of the war emergency each branch of the defense organization has striven to insure a completion of its own part of the program by placing orders and contracts without due regard either to the availability of funds or the adequacy of the industrial and transportation agencies of the country to perform the services expected of them. The professional civil and military purchasing agents of the government and the business men whose services are enlisted in the management of the mobilization program have all been trained in a situation where practically anything they wanted could be obtained by paying a sufficiently high price for it. They are slow to realize that the problem of war mobilization is too big to be handled by competitive methods, and that the only solution is to appraise the total volume of resources available and allocate them to different uses so as to develop a balanced and practical program.

Industrial concerns which are given government orders make the same mistake. They make commitments in the expectation that they will be able to secure the materials and parts from accustomed sources and later find out that these same sources are relied upon by others to render the same services. Both government agents and industry attempt to meet the situation by bidding higher prices and by placing excessive orders, hoping they will thus get enough even if the orders are only partly filled. The results are congestion in transportation and manufacturing, shortages of fuel and essential raw materials, and the skyrocketing of prices.

(b) *Competitive bidding for labor.* The withdrawal of men from industry to the military establishment decreases the available supply of labor at a time when the demand for labor, particularly of skilled types, is increasing. The competitive bidding for labor raises wages just as the competitive bidding for commodities raises commodity prices. The raising of wages in war industries tends to raise the level of wages in non-war industries as well.

(c) *The expansion of consumer buying power.* The money income of important sections of the population is increased by virtue of the

increase in both the number of employed workers and the average length of the working week, the increase in wage rates, and the increased profits and dividends which result from the expansion in the volume of business.

This expansion of consumers' purchasing power leads to an increase in the demand for consumption goods and creates a "sellers' market," with a resulting rise in prices. This result can be avoided only if the increased purchasing power of the public is promptly absorbed by the government in the form of taxes or loans. That is to say, the government must divert this increased purchasing power to war purposes if it is not to operate in the market to raise the price of ordinary consumer goods.

(d) *The expansion of bank credit.* All the preceding developments involve an increased flow of funds through the channels of trade. Their intensity and timing are dependent on the credit situation. To the extent that the government obtains its funds by borrowing through bank credit expansion it expands its own purchasing power without decreasing that of the public. Because the public has just as much money to spend as before, while the government now has added buying power, there is an increased aggregate money demand for goods; consequently, prices rise.

The result is the same if the government's securities are sold to the public and the public borrows from the banks the funds with which to buy them—as was done so extensively in the [first] World War. Again, the result is the same if the Treasury, instead of borrowing from banks, simply issues paper money with which to buy commodities—as was done in the Civil War. It must be emphasized again that only when the government raises its funds by taxing the people or by selling its securities to the public, with the public paying for them out of *current income,* is the stimulus to price advances avoided.

An expansion of bank loans to private business may also, under certain conditions, promote price advances. In the early stages of a war, when idle productive resources are still available, it is necessary for industries to increase their borrowings from the banks in order to expand production. Such credit expansion is not only desirable but essential. But as soon as the nation's productive sources are being fully utilized the further expansion of bank credit cannot increase total production; it serves merely to increase the market competition for the already fully employed men and materials.

(e) *Increased rapidity of expenditure of funds.* When price inflation has reached an advanced stage a tendency develops for individuals

and corporations to spend or invest their cash balances more quickly than they would under ordinary conditions, because of their anticipation that prices will rise still further. As this tendency develops a given amount of money will support a higher and higher price level. This propensity was only a minor factor in our own wartime inflation, but a very important one in the more extreme inflations that developed in various European countries. . . .

As the war mobilization progresses to the boom stage, the factors which we have been discussing tend to reinforce one another, and by a cumulative process bring about a familiar spiral of rising prices—rising costs—rising prices. The increase in prices creates "windfall" profits for business men; the rising cost of living stimulates further the demand for wage increases; rising values of securities and of real estate and other properties, together with increased profits, expand borrowing capacity; which in turn encourages banks to expand loans still further.

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CONVERTING TO MILITARY PRODUCTION

WALTER LORD

In today's atmosphere of international tension, every firm producing peacetime goods should consider carefully what it could make in the event of full mobilization. Failure to do so might find the company badly squeezed. . . .

A study of military contracts *since Korea* shows how a great many civilian industries have successfully shifted to defense production. The following list of 50 actual cases may point the way to similar conversion possibilities. . . .

This Peacetime Producer:	*Made This Military Product:*
Cotton goods	Camouflage nets, 2 x 6 yds. 12s
Textiles	Medical field kit, case M-2 empty
Burlap bags	Sand bags
Containers	Fiber containers M-, for 105 mm gun, T19
Paper tubes	Assembly support for packing rocket HE, AT3.5″
Gages	Rocket, plug, 4.5-inch projectiles
Plumbing accessories	Radar set components, cl 16 E
Woodwork	Packing boxes for 2.36 rockets
Metal plating	Incandescent floodlight, cl 08A
Cable	Tow target cable, Cl 04A
Scaffolding	Scaffolding for B-36, B-29, B-50, class 19A
Brake shoes	Shell body forgings, for 75 mm HE T50 E2
Gasoline pumps	Tank assembly, class 031
Cannery	Ammunition containers for tail bomb fuse
Doughnut machine	Aimable cluster adapters, for shells
Printing machinery	Range finder, T41
Laundry equipment	Mobile laundry, two-trailer type
Office machines	Bolt (for carbines, cal., 30 M2)
Lawn furniture	Mechanics' steel tool cases
Show cases and fixtures	Seat assembly and spare parts, class 03F
Displays	Terrain model
Musical instruments	Misc. spare parts, assemblies, subassemblies
Television	Radar training set, class 28
Small boats	Arctic shelters, class 19A
Toys	Metal parts for supplementary charge assembly
Home furnishings	Sleeping bags
Glass	Emergency signaling, mirrors, etc.
Sporting goods	Fishing kits, survival, class 13C
Bathrobes	Protective suit, one-piece impermeable
Novelty jewelry	Identification tag, necklace
Confections	Ration tablets for life rafts
Toilet goods	Bore brush for guns
Metal polish	Cleaner for rifle bore
Plastics	Chin straps, for helmet, M-1
Rubber goods	Fire fighting suits, class 13
Film specialties	Motion picture training film, class 28E
Soap	Boiler powdered compound: Navy standard
Embroidery	Chevron, insignia, combat (various)
Elevators	Range finder

Food processing	Final assembly and subassemblies of tobacco pack, toilet article pack, and confection pack, of ration supplement, sundries pack
Stoves	Shell fin, for 60 mm mortar
Enamelware	Steel body forgings, for 75 mm shell
Sewing machines	Gun parts
Vending machines	Gun turrets
Hand tools	Mast section, antenna
Metalcraft	Lighting kit for mobile bakery
Heaters	Fin assembly for 2.36 rocket
Cube steak machine	Chain sling
Aluminum ware	Mess bench
Mechanical pencils	Metal parts for detonator

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ECONOMIC STABILIZATION AGENCY

ERIC JOHNSTON

To BE SUCCESSFUL, the fight against inflation in a preparedness economy must be carried on in an integrated attack over four fronts. And all stabilization policies must be meshed not just with one or another of those approaches, but with all four of them.

These are the keys to stabilization:

1. INCREASING PRODUCTION

Every extra bit of output means a lessening of shortages or of anticipated shortages. The faster we produce the defense equipment we need, the sooner we can give the go ahead to stepped-up civilian production. Similarly, the more productivity and imagination we dem-

onstrate in meeting civilian needs in the face of materials shortages, the less we have to fear inflation.

2. RESTRICTING THE DEMAND FOR GOODS

As long as we do not have the materials and plant capacity to fill the requirements of defense and of civilian demand, we must keep our purchasing power under control so that it does not bid up prices and aggravate shortages.

3. HOLDING DOWN COSTS OF PRODUCTION AND DISTRIBUTION

As long as there are more jobs than workers to fill them and more demand than goods to buy, the pressures for higher wages on the one hand and higher prices on the other are almost irresistible. Stabilization must prevent profiteering by those in a preferred position in a sellers' market.

4. MAINTAINING CONFIDENCE

The fear of inflation is the greatest incentive to the public to do the very things that cause inflation—to get rid of their dollars as fast as they can in exchange for things. On the other hand, people will save and thus promote stability only if they have confidence that stabilization will work well enough to enable them at least to maintain their customary status in the economy.

In pursuit of these four paths to stability and strength, the Government can do many things to help. But, in the final analysis, it is the attitude of our people that decides whether we succeed.

THE MECHANICS OF STABILIZATION

In the fight against inflation, relying on any one stabilization tool would be as foolish—and as futile—as trying to fight modern war with artillery alone, or planes alone, or submarines alone, or any other single military weapon, regardless of its potency.

* * * *

The direct controls—over prices, wages, salaries, and rents—are front-line troops in the battle. They meet the enemy inflation head-on in the commodity markets, in the stores, in the real estate offices, in the employment offices.

The indirect controls—tax, and credit, and savings, and allocations policies—go to the sources of inflation's strength and can be used to

weaken the inflationary pressures before they actually get into the economic battlelines.

Both kinds of economic weapons are needed to fight inflation when the pressures are strong. . . .

For instance, if we were to depend entirely on price controls to carry the burden of the stabilization program, we could freeze prices solid and hold them there regardless of circumstances, but in doing so, we would soon find ourselves losing vital production and developing flourishing black markets.

Reliance on allocations alone would mean the rationing of nearly everything we use in the economy—a device sure to fall of its own weight.

A tax rate high enough to eliminate all inflationary pressures would have to be so high it would undoubtedly kill incentive to business, to agriculture and to labor to produce the goods we need.

Similarly, wage controls, or credit controls, or any other single type of anti-inflation weapon, could not by itself do the many things that must be done to achieve our four goals of increased production, restricted demand, stabilized costs, and the maintenance of confidence in the value of the dollar.

A balanced program of direct and indirect controls—one fair to all segments of the economy—can do the job.

That means:

Tax revenues high enough to maintain defense spending—over a period of time—on a pay-as-we-go basis without sacrificing essential production.

Credit restrictions strong enough to prevent the unnecessary expansion of purchasing power without denying funds for expansion of essential production.

Allocations policies that assure the flow of raw materials to essential production and that eliminate less essential business spending.

Price and wage controls that hold down costs without disrupting essential production.

* * * *

The controls over tax, credit, savings and allocations must, in the long run, carry the greatest burden of assuring a stable defense economy. . . .

There was an unfortunate tendency early this year to place too much reliance on the direct controls and not enough on the more basic measures in meeting the inflation danger. In midyear there was a further tendency, which showed itself particularly in the Congress, to weaken both the direct and indirect controls.

I want to outline the strength and the weakness of these other measures as they have appeared to me as administrator of the companion direct controls.

FOUR AREAS OF ACTION

1. RAW MATERIALS SUPPLY

The availability and price of raw materials are basic to our whole production program—and to our economic program as well. They go far to determine the volume of production, the availability of goods, the cost of goods.

The world-wide inflation which followed the outbreak of war in Korea began with a scramble on the part of all countries to achieve a satisfactory materials situation. Since there aren't enough of these materials to go around among all the nations which want and need them, the competition for essential supplies underlies the whole inflation danger.

One of our main defense jobs, therefore, is to stimulate the expanded production of raw materials, and then help to get fair distribution among ourselves and our allies at fair prices. . . .

On the domestic side, we have set up a Controlled Materials Plan and other allocations programs in our production agencies to direct the flow of raw materials from nonessential to essential uses. The allocations authority provided in the Defense Production Act is one of our best anti-inflation weapons.

Next, we have set up a central purchasing agency for the procurement of many essential materials abroad. . . .

As a third important step, the United States has joined with friendly nations in setting up the International Materials Conference to seek agreement among producer and consumer nations on the international allocation of raw materials. . . .

A fourth step we have undertaken has been the use of production subsidies and price and tax incentives here in the United States and the use of foreign aid funds abroad to bring out greater production of those materials in shortest supply.

* * * *

If the distribution of materials to our allies is permitted to continue on something of a haphazard basis, the American public will eventually pay the bill, in one way or another, for the lack of preparedness in Western Europe resulting from the inability of friendly nations to obtain essential supplies at prices their economies can afford. Materials shortages, unemployment, and failure to use plant

capacity fully are even now impeding the economic stability and the defense production of the NATO countries.

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2. CREDIT AND INVESTMENT POLICIES

Through the authority of the Federal Reserve System and other statutory powers, we had a strong framework of credit restraints designed to prevent a vast increase in purchasing power and in demand for scarce commodities through use of borrowed money. These restraints were effective during the first 7 months of 1951 in the fields of installment and other consumer credit, including mortgage credit. In addition, the voluntary credit restrictions adopted by the banks and other lending institutions of the nation have had a strong influence in holding down less essential business credit.

* * * *

In the field of capital formation, we have to draw a clear demarcation between the *desirable* and the *indispensable,* between what is needed now and what can be deferred until the military build-up can be completed.

For instance, much as we need and want more good housing for our people, because it is socially desirable, we simply do not have the raw materials at this time to enable us to meet defense goals and still turn out record production of new homes. . . .

This is also true of commercial and industrial projects—office buildings, stores, factories, and other construction not absolutely needed for defense or civilian needs. And wherever possible we should defer public projects, such as roads, hospitals, and schools.

3. TAX POLICIES

Taxes have already been boosted to high levels to meet our essential defense commitments.

Congress has raised tax rates on business three times and on individuals twice in three separate tax bills enacted since the start of the Korean war. It has reinstituted a modified form of the World War II excess profits tax and has reimposed or increased most of the World War II excise taxes. The tax take—a heavy one—is today an extremely strong ally of stabilization.

Nevertheless, as we step up our defense expenditures, we are being forced into deficit financing in this fiscal year. Next year, under present

tax policies, the spread between revenues and expenditures of Government will undoubtedly be greater.

That spells inflation danger. To meet it successfully, we must either reduce Government expenditures or increase revenues or both.

I cannot urge too strongly the need to exercise the strictest economy in Government—Federal, State, and local.

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4. SAVINGS

No one concerned with economic stabilization can complain today over the rate of savings of the American people since direct controls went into effect last January. By restoring confidence in the dollar, they stopped the headlong rush of consumers to buy everything in sight. As a matter of fact, the rate of savings is now so high that many businessmen are complaining of slackened sales and burdensome inventories.

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OPERATIONS OF PRICE STABILIZATION

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I have found, however, that there is a widespread and fallacious belief that effective price control means frozen and unchanging prices for each commodity.

Such a freeze is unsound price policy. Moreover, the law does not permit it. Its inflexibility would make it self-defeating in a dynamic economy. It would strike at the main goal of our whole mobilization effort—a vigorous expansion of needed production.

Ours is an incentive economy. We must keep it that way. Incentive to produce has been the secret of our remarkable industrial strength and the key to our unprecedented standard of living.

Our pricing policy, therefore, is to stabilize the general price level while keeping individual prices in fair relationships and allowing for the price flexibility necessary to bring out production.

* * * *

THE FREEZE

Prior to the freeze, ESA . . . had tried to stem the force of the fear-induced inflationary pressures with a program of voluntary restraints.

This was required in the Defense Production Act as a prelude to compulsory controls.

The voluntary method did not, and probably could not, work effectively. Despite the warning implicit in the voluntary program that compulsory controls would follow a failure of the voluntary system, the plea to hold prices to the December 1 levels was generally disregarded and prices continued to rise higher and higher throughout December and January.

A great many businessmen were forced to raise prices by higher costs, particularly of raw materials. Some were cashing in on a demand market. Others were anticipating the compulsory controls and seeking to establish favorable base prices before controls went on. During this period mandatory selective controls authorized by law were used on only one major product—automobiles. However, several other basic industries did agree not to raise their prices and stood by their agreements.

By the time I took office, the rate of price increases had reached such an alarming level that there was no opportunity to make careful studies of possible base periods or anything of the sort. It was a time for immediate action to stop this spiralling of prices.

* * * *

Some retailers had jumped their prices and their margins before the freeze, while others were still selling old merchandise off the shelves at prices below new replacement costs.

Some fabricators had increased their prices not only enough to cover previous raw materials increases but in anticipation of future ones, while others were caught with prices still unadjusted for any increase in costs—and there had been many such cost increases.

The opportunists had, of course, raised their prices too high in relation to costs before the freeze. In many cases, the freeze penalized businessmen who complied with ESA's voluntary program by holding their prices too low in relation to costs.

Obviously this situation was unfair and needed prompt correction.

INTERIM PRICING POLICIES AND TAILORED REGULATIONS

To relieve these inequities the Office of Price Stabilization, immediately after the freeze, plunged energetically into the hard and complex task of issuing special regulations for hundreds of different trades and industries.

In some fields this meant rollbacks of excessive raw materials

prices, notably in scrap and byproducts, which were frequently higher than prices for primary products.

In the retailing and distributing fields it meant the allowance of customary margins or markups over the merchant's costs of the goods.

In manufacturing it meant a recomputation of prices based on pre-Korean prices plus measurable added costs since then.

In beef it meant a rollback of cattle prices, which were by then 1½ times the parity price (parity is the statutory measure of a fair price for agricultural commodities), and the establishment of dollars-and-cents ceiling prices for various cuts of meat.

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These interim regulations permitted businessmen to compute their own ceiling prices from general standards laid down by OPS, calling in some cases for rollbacks and in others for justifiable price increases. The next step was to be a series of tailored regulations setting uniform dollars-and-cents ceilings wherever practical for product after product in industry after industry.

Uniform price ceilings provide price control with its greatest enforcement tool. The housewife, for instance, can quickly learn the ceiling prices for the things she buys and can thus be her own enforcement agent to protect herself against overcharges. Where many businessmen, using similar pricing standards, come up with different ceiling prices for the same article, the customer is at a disadvantage in recognizing overcharges.

PRICING STANDARDS

The basic prerequisite of any effective price-control system—or of any other system of government controls in a democracy—is fairness to all groups in the population. In developing our pricing policies, we were all determined to assure fairness to every segment of the economy—to seller and to buyer. It has been our cardinal principle to protect the legitimate interests of business as well as of consumers.

* * * *

Consequently, the so-called industry earnings standard was developed to fit that need for minimum protection to business. Under this standard, the prices in any industry can on its application be increased whenever its average return on net worth falls below 85 per cent of the average for the three best years from 1946 through 1949—the base period then specified for the excess profits tax. The

earnings standard is not designed as profit control. It is an assurance to business against ceiling prices set too low to allow a fair and equitable return on operations.

* * * *

Subsequently, in voting to continue the act until June 30, 1952, Congress adopted a series of weakening changes in the price-control provisions.

* * * *

Another serious roadblock to price stabilization is the lack of effective authority to maintain stable ceilings on food. Under the Defense Production Act, farm commodities cannot be placed under price ceilings until they reach parity. Most of them have been selling below parity prices. When any do reach parity levels, the ceiling prices put on them must be subject to change month by month, because the parity level itself fluctuates monthly.

* * * *

OPERATIONS OF WAGE STABILIZATION

If we are serious about stabilizing prices in this period of defense emergency, then we must be equally serious about stabilizing wages. The two go hand in hand.

What happens to the price level depends to a great extent on what happens in two areas where wage levels are exceedingly important —if not controlling—factors. These are:

(a) The costs of production.

(b) Consumer purchasing power.

Unrestricted wage increases in a manpower-short defense economy could raise production costs and purchasing power so high that reasonable, stable price ceilings could not hold long against the impact of inflation. Higher prices in turn would mean more wage demands —a merry-go-round of prices, wages, costs in a full-blown inflation spiral.

Unrestricted competition among employers for manpower at ever-higher wages could lead to chaos in production as workers shifted from plant to plant in order to cash in on their pay opportunities.

Unrestricted racing between unions to catch up to, or get ahead of one another in wages and other benefits could lead to widespread and paralyzing industrial unrest.

The economic and military consequences of such a combination of wage inflation factors would be tragic to defense.

That is why the Defense Production Act, with good common sense, requires that under conditions of general price control we must also have a companion policy of general wage control.

But just as price stabilization does not mean a rigid freeze of all prices, so wage stabilization does not mean a rigid freeze of all wages—and for much the same reasons.

These reasons not only relate to production needs—they also involve basic principles of fairness and equity.

A freeze of wages, as of prices, would wreck the dynamic flexibility characteristic of this economy. It would completely destroy collective bargaining throughout the Nation. As in the case of a price freeze, it would perpetuate gross inequities among workers. It would prevent the largest part of our population from sharing in the benefits of our increased production.

In a dictatorship men can be ordered to take jobs at any pay rate—and be glad they escape the concentration camp. In our system, we get people to take jobs—and to work harder at them—by providing real and tangible opportunities for a fair share of the fruits of our capitalism.

WHAT WAGE STABILIZATION MUST DO

In the process of wage stabilization we must balance off what often may appear to be antagonistic objectives and make them compatible with effective stabilization.

These objectives, set forth in the law, are:

Stability in industrial relations.

Preservation of collective bargaining to the fullest extent possible.

Correction of inequities.

Attainment of maximum defense production.

There are some who believe these objectives are so completely antagonistic that it is futile to try to reconcile them. I think we must reconcile them.

We cannot afford to let wages get out of hand, but neither can we afford to freeze wages at the expense of production and fair play.

There is a sensible middle path and we have been moving along it. . . .

All these have been accomplished without any serious wage push against the general price level. I believe that workers should retain the opportunity to have their wages keep up with the cost of living and to share, as historically they have always done in America, in a fair apportionment of the benefits of our increased production.

Our wage policy has worked effectively for two reasons:

1. It is a fair policy—fair to the worker, to the employer, to the consumer, to the country.
2. It has had the understanding cooperation of labor and of management.

In our democratic society no wage stabilization policy can be effective unless these two conditions prevail.

THE FREEZE AND THE CATCH-UP

The January freeze order caught wage rates in the same kind of distorted relationships as prices.

Millions of workers are covered by collective bargaining agreements customarily extending for periods of a year or more. Contracts negotiated during the first half of 1950 had, in most cases, provided for only moderate wage increases following the mild 1949 recession. By the latter half of the year, however, prices were going up so fast that new wage contracts carried increasingly greater wage increases. . . .

When the wage freeze was imposed, there was no way the workers left behind in the rush for higher wage rates could catch up to those who had held their own in the face of rising prices.

Therefore, one of the first jobs tackled by the Wage Stabilization Board after the freeze was to settle on a fair catch-up formula for those workers whose wages were still geared to pre-Korean living costs. The three industry members and three public members of the nine-member tripartite board cast a majority vote for a policy permitting all wage rates to go up 10 percent above the levels in effect on January 15, 1950. This was only slightly above the rise in the cost of living from January 1950 to January 1951.

Under the terms of the formula, employers and employees could still bargain for increases over the permissive 10-percent limit, but such contracts had to be justified by special circumstances and required specific board approval.

The 10-percent formula has sometimes been referred to as the wage "ceiling" and as *the* wage policy. This is not correct. It was actually only a first step in the development of a broad wage stabilization program designed to meet the complex needs of our economy.

* * * *

The development of such a policy was long delayed, however, because the labor members had withdrawn from the Board earlier in February as part of a general protest against defense policies. I spent more than 2 months trying to break the impasse, for I believed that

sound wage stabilization in a democracy could be handled best through the tripartite approach.

It was not until April 21 that the Board, enlarged to 18 members—six each representing the public, labor, and management—was formally reconstituted by Executive order, and it was May before the Board was actually functioning again.

* * * *

FUNDAMENTAL POLICY PROBLEMS

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But there was one important new problem which had not existed in World War II. This was the emergence of a substantial number of long-term wage agreements which provided that wage levels would regularly be adjusted to reflect these two things:

(a) Changes in consumers' prices—up or down.

(b) Advances in productivity at a rate approximately equal to the long-term rate of increased output of the American economy as a whole.

These factors have long been implicit in our collective bargaining practices even though they had not been generally applied in exact terms. Traditionally, wage rate adjustments have reflected living costs and a steady boost in real wages as our national productivity increased.

So far there has been no compelling necessity to interfere with the continued operation of contracts of this type which went into effect before wage controls were imposed. . . .

But should this principle be extended to other workers who had not had similar contracts before wage control? This question had been partly resolved by authorizing the cost-of-living escalator principle to be used generally to keep real wages abreast of living costs.

The more puzzling question—whether, and how, to permit improvement in real wages in industry generally—is still before the Board for consideration and decision.

THE CURRENT WAGE PICTURE

Wage increases come about in manifold ways. Cost-of-living increases, correction of inequities, manpower recruitment increases, pensions and similar benefits, and direct increases in real wages are all important avenues.

In addition, there are other means whereby wage raises come about during periods of tightening labor supply. For instance:

Employees move to higher-paying plants and industries, or to higher-paying jobs within the same plant; merit and progression increases are paid within job grades; jobs are revalued and wage rates readjusted; incentives are provided for improvement; premium rates are paid for extra hours of work or for certain shifts.

An effective wage policy must deal with all these facets of the problem. . . .

It is also clear as a general matter that the aggregate increase in labor's real compensation, in whatever form it may take, cannot exceed the rate of growth of the nation's productive efficiency except at the expense of other groups in the economy.

* * * *

And partly because of higher taxes, real net spendable weekly earnings have actually been averaging less in recent months than before Korea. Of course, this is not to say that wage policy should be used to relieve workers of their fair share of the increased tax burden—certainly it should not. But the combination of these facts show no great, unreasonable push against wage stabilization barriers.

* * * *

OPERATIONS OF SALARY STABILIZATION

In a period of general wage controls, it is not only fair but essential that there be control also over the compensation of managerial and related personnel, such as executives, administrative and professional employees, and outside sales representatives.

To allow management officials a free hand in setting their own or one another's remuneration while wage earners in the same concern are limited in the increases they can be paid would certainly be unfair. The controlled wage earner would have every right to regard the controls program as discriminatory.

In addition, the pirating of managerial and professional manpower through unrestricted offers of more pay or other benefits would be a blow to orderly production just as it would be if production workers were involved.

Nevertheless, the mechanics of salary stabilization must, of necessity, be somewhat different from the operations of wage stabilization, even though the basic rules of the two programs should be similar. The situations in salary cases are far more individual, the methods of

compensation tend to be more complicated, and the opportunities for changes in designated assignment are generally more numerous.

* * * *

For these reasons, I established within ESA last May a separate Salary Stabilization Board of five public members and an Office of Salary Stabilization to take jurisdiction over the compensation of persons employed "in bona fide executive, administrative, professional, and outside salesmen capacities . . . and who in their relationships with the employers are not represented by duly recognized or certified labor organizations."

The order requires that the salary board shall "conform to the regulations, policies, orders, and decisions of the Wage Stabilization Board to the fullest practicable extent."

The salary board sat down to its job with a backlog of 2,000 cases. Many of these involved such things as stock options, nonproduction bonus payments, and other special forms of payments which could not readily be dealt with on a case-by-case basis. The first need, therefore, was for the development of a comprehensive set of regulations under which the salary program could be virtually self-administered.

The initial regulation provided a general set of rules to govern salary payments to the great bulk of all salaried workers, and it was designed to maintain customary and historical ratios between salaries and wages.

In subsequent actions, the salary board specified general policy on such specialized situations as profit sharing and bonus payment arrangements, and stock option and stock purchase plans. It is working with the Wage Stabilization Board in areas where the two boards have closely related problems, such as in connection with health, welfare, and pension plans.

RAILROAD AND AIRLINE WAGES

The Congress directed in the Defense Production Act Amendments of 1951 that special machinery be established under wage stabilization for railroad and airline wage cases. In conformance with the legislation, the Railroad and Airline Wage Board was created in September 1951 to handle the wage cases of employees subject to the Railway Labor Act. RAWB works closely with WSB and SSB to make sure it follows the general pattern of stabilization policy.

OPERATIONS OF RENT STABILIZATION

In areas of housing shortage and high defense activity, rent stabilization is an integral part of any effective anti-inflation program. Rent is one of the most important single items in the average family's cost of living.

Unrestricted rent increases to defense workers, especially in crowded production centers, hurt the important drive to recruit manpower from other areas to take essential jobs. Rent gouging in the vicinity of reopened aircraft factories, for instance, has been blamed for high labor turnover and a resultant loss in critically needed plane production.

Unrestricted rent increases to families of servicemen even for shacks and chicken coops in the vicinity of reactivated military installations are bitter blows to the morale of men called back into the armed services. Rent gouging of these men and their families near some camps has been a national disgrace.

The housing shortage and the accompanying dangers of rent inflation are by no means attributable only to the inflationary movements which followed the outbreak of the Korean war and the start of our great rearmament program. Even before war in Korea, and despite several years of record-breaking housing construction, more than 200 urban centers in the United States were still living under the Federal rent control program initiated in World War II.

In view of the fact that each of these communities was free to decontrol itself by local action, presumably each regarded its housing shortages to be acute enough before Korea to warrant continuation of Federal controls.

For more than a year after the outbreak of the Korean war, however, while compulsory direct and indirect anti-inflation measures were being applied elsewhere in the economy, there was no authority in the Federal Government to stabilize rents in uncontrolled or decontrolled areas, regardless of defense activity and mounting rents.

Yet in an increasing number of such areas, defense preparations were causing such heavy pressure on rents that the need for rent stabilization became urgent. To meet this need, Congress this year revised the Housing and Rent Act of 1947 to provide machinery for initiating rent stabilization under certain circumstances in critical defense areas.

POLICIES OF RENT STABILIZATION

ESA's Office of Rent Stabilization—until last August an independent agency known as the Office of the Housing Expediter—has

had continuous experience in the administration of rent stabilization since the end of World War II. . . .

Since August, however, it is directing two different types of rent stabilization programs:

1. IN CONTINUOUSLY CONTROLLED AREAS

In areas continuously under rent control since 1947, many types of housing accommodations are expressly exempt from control by law. Others are subject to rent ceilings 20 percent higher than the rent in effect June 30, 1947 (unless there have been decreases in space, services, furniture, furnishings, or equipment) plus any additional amounts allowed for such things as major capital improvements and increases in living spaces.

* * * *

2. IN NEWLY DESIGNATED CRITICAL DEFENSE HOUSING AREAS

Rent stabilization jurisdiction is virtually complete and all-inclusive in areas designated by the Secretary of Defense and the Director of Defense Mobilization as "critical defense areas," including new construction, modified or converted units, hotels, motor courts, trailers—all exempt from rent stabilization in the continuously controlled areas.

* * * *

PART NINE

Problems of Insecurity

THE FIRST READING in this Part (121) calls attention to the beneficial aspects of the medieval guild, in a sense the forerunner of modern insurance. The meaning of security and the two major characteristics of American social security are explained in Selection 122 by Eveline M. Burns. Number 123 is a consideration of future problems of social-security payments by Lewis Meriam, K .T. Schlotterbeck, and Mildred Maroney. In Article 124, the pressing problem of old-age security is treated by Sumner H. Slichter. In Selection 125, Thomas Nixon Carver raises some basic issues regarding welfare. Donald R. Richberg, one-time counsel for the N.R.A., suggests the dangers to private associations in a welfare state. Number 127 is Roscoe Pound's searching analysis of the service state.

Other selections which might be read in connection with this Part are Articles 14, 16, 84, 94, and all the selections under Part XI.

The sources of copyrighted materials, used with permission, as well as the sources of other materials reprinted herein, are acknowledged below.

(121) Guild of Killyngholme, Lincolnshire, *Early English Gilds,* E.E.T.S., p. 185.

(122) Burns, Eveline, *The American Social-Security System,* Houghton Mifflin, 1949, pp. 3–7, 45–46.

(123) Meriam, Lewis, K. T. Schlotterbeck, and Mildred Maroney, *The Cost and Financing of Social Security,* The Brookings Institution, 1950, pp. 173–176.

(124) Slichter, Sumner, "The Pressing Problem of Old-Age Security," *New York Times,* October 16, 1949.

(125) Carver, T. N., *A Report on the Problem "What Must We Do to Save Our Economic System?"* Los Angeles: Parker & Baird, 1935.
(126) Richberg, Donald R., address given at Harvard University, July 24, 1950.
(127) Pound, Roscoe, address delivered before the Economic and Business Foundation, New Wilmington, Pa., 1949.

121 · BENEFICIAL ASPECTS OF A GILD

An ordinance was made by the bretheren and sisteren of the gild, on the Monday next after the Purification, A.D. 1310, that if a brother or sister dies, four bretheren shall offer a penny, and each sister shall give a halfpenny loaf.

If a brother or sister is unlucky enough to lose a beast worth half a mark, every brother and every sister shall give a halfpenny towards getting another beast.

If the house of any brother or sister is burnt by mishap, every brother and every sister shall give a halfpenny towards a new house.

Moreover, if the house of any brother or sister is broken into by robbers, and goods carried off worth half a mark, every brother and every sister shall give a halfpenny to help him.

If any brother or sister has a friend at his house, for love of whom he does not wish to go to the gild; and if there is no retail tavern in the soke [neighborhood?] where he dwells; he may send for a gallon of the best ale to the Bailiff of the gild; and the Bailiff shall give it him. But if it is found by his bretheren that he had no guest, but stayed at home through idleness, he shall be in the "Gildwyt" [a fine] of half a bushel of barley.

If any brother or sister is chosen to be Provost for a year, by the four Provosts of the past year, and will not serve, he must be in the "Gildwyt" of half a bushel of barley, and be quit as soon as the others have been chosen.

122 ·

THE MEANING OF SECURITY; THE MAJOR CHARACTERISTICS OF SOCIAL SECURITY

EVELINE M. BURNS

At the beginning of 1948 at least 10 million people were deriving all, or a substantial part, of their income from one or another of America's social security programs. Even allowing for a small amount of dual reckoning because some people draw payments under more than one program, and for the fact that the payments made to a considerable number of the roughly 2 million disabled veterans included in the total may have represented an addition to, rather than a substitute for, normal earnings, the number is still very large. Furthermore, it is probably an underestimate, because in some cases the statistics fail to indicate the number of dependents who are also supported by the payments, and the beneficiaries of one program, workmen's compensation, are omitted entirely because of lack of data.

The number seems especially large when it is recalled that the period was characterized by high employment and a steadily rising national income. During the depression years of the 1930's, estimates of the numbers of individuals (excluding veterans) who derived income from one or another of the social security programs fluctuated from a low of 7.95 million (September, 1937) to a high of 28 million (February, 1934), or between 10 per cent and 22 per cent of the total population.

Social security payments have indeed come to be a not insignificant item in the total of incomes received by individuals. In the calendar year 1947, total personal income amounted to \$196.8 billion, of which \$6.4 billion was represented by public assistance payments (\$1.5 billion) and social insurance and veterans' payments (\$4.9 billion). This was equal to almost half the total income received by individuals in the form of dividends and interest, and a little over 3 per cent of

the total of personal incomes. In periods of depression, when national income shrinks and payments to the unemployed expand, the significance of social security payments becomes even greater. In 1938 and 1939 they formed between 9 per cent and 11 per cent of total income payments to individuals.

It is evident that social security is now an important institution. But what does "social security" include? To some people the term conveys the idea of "income security," that is to say, the measures that modern societies are increasingly adopting to assure to some or all members a certain minimum of income. Others identify "social security" with one particular method of assuring income security, namely, social insurance. It is in this sense that many Americans use the term when they demand "an extension of Social Security." Yet others understand by "social security" the whole range of income security, health and welfare services such as were envisioned in the original Wagner-Murray-Dingell Bill. In certain foreign countries the term has been given an even wider connotation, and in addition to the foregoing group of welfare services, includes also housing and measures aiming at increasing incomes from work, such as minimum wage legislation. Still more confusing is a tendency found in some quarters to use the vague and comprehensive word "security" as if it were interchangeable with "social security."

It is not surprising, with this variety of meanings, that great difference of opinion prevails as to the consequences of social security legislation, and that there are doubts as to whether a comprehensive social security program is at all possible in our kind of society. The prophets of gloom delight in asserting that the desire for social security is a sign of decadence. Its satisfaction, it is alleged, will result in a rigid society in which no one will take any risks, and all will strive to protect themselves in their existing jobs and status in society. This might be true of "security" in the broad general sense, but it is not likely to be true of a minimum income security program in a country like America where the rewards from participating in production are considerably in excess of the living standard available on the security programs and where the desire for a high standard of living is fostered by so many social institutions. Some hold that social security will mean a vast extension of the activities of government and subordination of the nation to a race of bureaucrats who will control every aspect of the citizen's life. This would be a danger only if social security meant the same as socialism, which of course it does not. It is said that social security will make people lazy, improvident, and greedy, and will develop a population that is soft rather than hard. Cer-

tain types of income security programs might have this effect, but it does not necessarily follow that every income security program would have these dire consequences. It is claimed that the costs of social security are limitless and that the end will be an impoverished country and a bankrupt treasury. This could conceivably be the consequence of certain types of social security program, especially in countries whose level of productivity is very low, but again, it is not a necessary consequence of all such measures, especially those limited to income security in wealthy countries.

Thus, before the American social security system can be discussed, we must be clear as to the meaning of this term. Obviously, it does not mean absolute security in the sense in which Dr. Hayek most frequently uses the words in his recent defense of laissez faire, *The Road to Serfdom*. Dr. Hayek points out that there are two kinds of security:

> the limited one which can be achieved for all . . . and absolute security, which in a free society cannot be achieved for all. . . . The two kinds of security are, first, security against severe physical privation, the certainty of a given minimum of sustenance for all; and second, the security of a given standard of life, or of the relative position which one person or group enjoys as compared with others; or as we may put it briefly, the security of a minimum income and the security of the particular income a person is thought to deserve.

None of the social security plans now in existence or, indeed, in contemplation, conceive of social security in this second sense. All are concerned rather with the problem of assuring a given minimum standard of living. They do, however, differ considerably in what is embraced by this minimum and in the methods by which it is to be assured. More and more clearly a distinction is being recognized between income security programs on the one hand, and other measures which meet other individual or social needs on the other. Among these other measures are health, housing, child welfare services, individual counseling, case work, and the like.

[By *income security programs* are meant] those public measures which have as their object the assurance of a certain minimum of income to some or all members of the population. . . . For within certain limits guarantees of minimum cash income to the individual or family and the direct public provision of goods or services are alternative methods of approach to a common goal, namely, the assurance of a minimum of well-being. Thus, minimum well-being assumes an acceptable standard of health, and this might be assured either by guaranteeing cash incomes sufficiently high for each family to purchase

essential and appropriate health services, or by making adequate health services freely available to all, as needed. From this point of view the system of relief in kind, so long characteristic of the poor law and still not unusual in some general public assistance administrations in certain localities, can be regarded as merely a very primitive and restricted form of the "service approach" to social security, an approach which at the other extreme might include an integrated system of cash payments and health and welfare services, or a very extensive network of publicly provided goods and services available to all, regardless of income.

The device of guarantees of minimum cash income has, however, increasingly become the major method by which modern societies seek the assurance of a minimum of general well-being, and the predominance of this method appears to accord with public sentiment. Assurance of minimum cash income has, indeed, the advantage of leaving the private individual a maximum of freedom in running his own life and spending his income. It does not involve government in the difficult task of directly providing services and deciding which ones would be "good for the citizens," and to the more conservative, it has the further advantage of avoiding the establishment of dangerous precedents for public operation of large public undertakings.

Nor is there any necessary reason why this type of social activity should interfere with the determined search for longer range and more fundamental attacks upon such of the root causes of economic insecurity as may be amenable to control. Prevention is obviously superior to palliation, but preventive measures often take time and, until success is achieved, individuals will be subject to interruptions of income. Insofar as it lessens the present burden of economic insecurity falling upon individuals and families, social security legislation takes its place as an integral part of a comprehensive program of social welfare.

* * * *

The American social security system is marked by two major characteristics: a great diversity of programs, and the participation of several levels of government. Diversification of programs, in turn, stems from two other characteristics of the American approach to the problem. First, several social security techniques are in simultaneous operation. Social insurance, special and general public assistance, and status pensions for veterans all play an important role in the total combination. Although work programs today are insignificant, the absence of any formal provision for the long period unemployed, together with the pronounced American dislike of the "dole" and expressed prefer-

ence for work opportunity, justify the presumption that, if unemployment again became severe, some type of work program would again be reintroduced and would increase still further the number of programs.

The diversification of programs reflects, in the second place, a policy of classifying the population for social security purposes on the basis of the risks to which they are exposed and to provide against these risks by separate plans. Thus we find special security measures (which may be either social insurance or public assistance) for the aged, the unemployed, for those exposed to life and health hazards arising in connection with military service or industrial employment, for children who have lost a breadwinner, and the like. Indeed, to add to the complexity of the structure, American policy has, for social security purposes, also differentiated between persons on the basis of their industrial affiliation. Separate old age, disability, and unemployment insurance measures exist for railroad employees.

The second major characteristic of the American social security system is the participation of several levels of governments in the administration and operation of the laws. Some programs are wholly federal, others wholly state or local; some involve federal and state participation, while in others the federal government plays no role; some programs call for the participation of all three levels of government. This complicated administrative structure reflects the political organization of the United States and the historical distribution of responsibility for specific functions between the various levels of government, attitudes within the states, and the specific techniques of social security which have, in fact, been adopted. Over the years there has been a pronounced trend toward assumption of financial and administrative responsibility for social security functions by larger units of government.

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THE NATURE OF THE DILEMMA

LEWIS MERIAM, K. T. SCHLOTTERBECK,
and MILDRED MARONEY

THE COMPLICATIONS arise out of the attempt to apply private insurance concepts to a public system. The terms "insured status" and "legal or actuarial reserves" imply a resemblance to private voluntary insurance plans; but the resemblance is fictitious—for the reserves are not *real* reserves and the protection of the insured rests not on invested assets but solely on future taxable capacity.

The use of this insurance concept appeared to necessitate the assessment of special taxes against employers, employees, and the self-employed. Under such a contributory system the government can attempt to collect in each year through taxes on employers, employees, and other prospective beneficiaries the true actuarial cost of the future benefits which will have to be paid ultimately with respect to the services rendered in that year. In other words, it can attempt to operate, as do insurance companies selling ordinary life policies, on a level premium basis. Its premiums or taxes remain at a constant rate throughout the working life of a covered employee.

But as the old-age and survivors system started without any benefit load and will not take on its full benefit load for some fifty years, collection of actuarial level premiums as taxes necessarily produces for a time far more revenue than is needed to meet current benefit and administrative costs. A huge excess of receipts over expenditures is therefore created for the benefit of the actuarial reserve account. The government is then confronted with the problem—how to handle this money.

Private insurance systems simply invest the money in securities or other properties. But under the governmental system the volume of

funds would ultimately be so large that ordinary investment outlets would be wholly inadequate. In view of this situation the alternative was for the government to borrow the excess insurance funds and evidence its indebtedness by placing government bonds in a so-called reserve.

The difficulty arises when the annual costs in due course come to exceed the receipts from the special taxes. At that time it will be patent that the United States governmental debt obligations held in the reserve fund are not earning assets. The government must then raise the necessary cash to meet benefit payments and other costs by general taxation or by borrowing in the bond market.

The taxpayers of today pay the special taxes uncomplainingly because they believe they are buying social security. They do not rebel against those taxes as they would against taxes levied for the general purposes of government. They do not appreciate that most of the proceeds of the pay-roll tax on wages up to $3,000, a regressive tax, are actually being used to finance current operations and that the assets of the fund are simply debt liabilities of the government. Many opponents of the reserve fund believe, moreover, that any large excess of social security taxes over immediate benefit payments encourages government extravagance or wastefulness.

Because of these objections, opponents of the level premium and the full reserve take the other horn of the dilemma. They advocate a so-called "pay-as-you-go system." The idea is to levy only such current social security taxes as are required to meet current benefit and administrative costs. As the benefit payments and administrative costs rise progressively, as they will for fifty years or more, the special taxes will rise. In their upward movement they will after some years equal and then exceed the level premium. The fact that they will ultimately substantially exceed the level premium does not disturb the advocates of this system. They point out that the children and the grandchildren will have to pay the costs of the benefits and administration in their day anyway, and it is immaterial whether they pay the sum in one social security tax or in a level premium social security tax plus the taxes necessary to pay interest and principal on the governmental debts held in the actuarial reserve. The only possible difference between the future taxes would be in their incidence, and no one can foresee conditions in the year 2000 with sufficient clarity to appraise the incidence of the taxes that will then be in use. This pay-as-you-go plan, it will be observed, discloses the hollow fiction of the idea that the system is genuinely contributory and that employers and employees through their taxes are providing real insurance for themselves.

Under this system, however, a time would come some fifty years hence when current taxpayers would be meeting the true costs of the system. But in the meantime persons who draw benefits will have paid or occasioned the payment of only a fraction of the true costs of their benefits. The present generation thus says, in effect, to future generations, "We do the promising, you do the paying."

The essence of this system may be stated as follows: We say that our generation will take care of such of our citizens as can prove *need* through means test public assistance, raising their resources to the requisite minimum. For those whose resources are above that minimum we do nothing unless they have been under the insurance system for the length of time prescribed by Congress for acquiring an insured status. We do not assume the load which we attempt to direct future generations to assume. We allege that we could not at present afford the cost of "no means" test payments to our old and disabled persons and those dependent on them. We assume that future generations can and will.

The way to avoid the dilemma of the current pattern of old-age and survivors insurance, with its pseudo resemblance to private insurance, is to abandon it entirely. In its place should be substituted a system that assumes responsibility for the full current load to the extent that provision seems socially desirable and can be made within our present capacity to pay. Then we can be on a genuine pay-as-you-go basis. Each year benefits will be paid to those in need of them and current taxpayers will supply the required funds. There will be no reserves, no level premiums, no taxes being increased according to a schedule contained in an act of Congress attempting to forecast the distant future and to bind children and grandchildren. Our generation would care for its own and trust future generations to do likewise.

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THE PRESSING PROBLEM OF OLD-AGE SECURITY

SUMNER H. SLICHTER

LESS THAN HALF OF THE MEN and less than one out of ten of the women of sixty-five years of age or over in the United States are at work. A man of sixty-five years of age may expect to live on the average about twelve years longer; a woman nearly fourteen years. How are people going to support themselves for twelve or fourteen years without working? An annuity paying $100 a month for life, if purchased at the age of 65, would cost more than $15,000. If it also provided a payment of $75 a month to a wife who survived her husband and who was about the same age as the husband, it would cost several thousand dollars more. Few persons who reach the age of 65 have savings of $15,000 or more. Consequently, the voluntary savings of individuals can meet only a small part of the need. How retired workers shall be supported is plainly one of the biggest economic problems in the United States.

What should be done about the problem of security in old age? Is the problem being made unnecessarily large and difficult by unwise retirement policies on the part of business? How good are the four principal ways through which the country is now attempting to meet the problem—employer-initiated pension plans, union-negotiated plans, the Federal old-age assistance plan, and the Federal old-age pension plan? Do these plans need to be supplemented or superseded by new arrangements? In particular, how good are the pension plans that have been negotiated by trade unions? The fact-finding board in the steel case said that so long as the Government fails to provide security in "an adequate amount, industry should take up the slack." Is this reasonable? Are union-negotiated plans a good way of meeting the problem of old-age security?

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The seriousness of the problem of old-age security is greatly aggravated by the unwise retirement policies of business. Few people retire voluntarily—most retirements occur against the will of the worker at the decision of the employer. The community obviously would be better off if the older persons who were willing to work had jobs and were producing goods. Furthermore, most persons would be happier at work than they are in retirement. Special reasons for early retirement exist, it is true, in the case of executives, technicians and professional people, who hold jobs that require imagination, originality and resourcefulness. These jobs are best held by relatively young men.

For the great majority of jobs, however, the age of 65 is too early for retirement. Hence, the growing practice of retiring all persons at the age of 65 should be decisively halted. Had the rule of retirement at 65 been generally in effect in August, 1949, 3 million fewer people would have been at work in the United States, and the annual output of the economy would have been nearly $11 billion less—except to the extent that the dropping of older workers might have raised the efficiency of younger workers.

Although a higher age of retirement would diminish the size of the problem of old-age security, it would not eliminate the problem. Even at the age of 70 the average male may expect to live nine years longer. An annuity of $100 a month for life at the age of 70 would cost him in excess of $13,000—certainly more than the average worker of 70 would have. Let us look, therefore, at the four principal ways which are now used to provide retired workers with incomes and let us see whether any of them offers a solution for the problem.

1. EMPLOYER-INITIATED PLANS

These plans have been growing by leaps and bounds—from fewer than 200 in 1915 to more than 400 in 1929 and more than 9,000 today. In the last ten years their growth has been greatly stimulated by the tax laws. More than three-fifths of the employer-initiated plans are non-contributory. Most of the plans were started in order to permit firms to make some overdue retirements. Under the circumstances, managements were hardly able to ask employes to contribute.

Pension plans initiated by private employers have four major deficiencies, and they are clearly not the answer to the problem of old-age security—though they may do much good in the plants where they operate. A primary major deficiency for employer-initiated pension plans is that they will never give adequate coverage. One reason for this is that they do not apply to self-employed persons, of whom there

are about 11 million in the United States. They need a source of income after retirement no less than do employes.

Employer-initiated pension plans also fail to give adequate coverage because they are expensive. Hence, only the more prosperous companies will adopt them. Even in the highly prosperous year of 1945, more than one-fourth of all corporations were "in the red." Pensions, depending upon their size, are likely to cost at least 6 to 8 per cent of payrolls. This does not include the special cost of meeting the large accrued liability with which most pension plans start. This special cost is a result of the fact that the plans apply to employes who have worked for the employer for many years and who will soon have reached the age of retirement. No payments have been made before the initiation of the scheme to buy pensions for these employes.

Finally, the employer-initiated plans will not give adequate coverage because they are limited to certain types of employes—usually long-service employes. The present 9,000 employer-initated plans cover a little more than one-third of the employes of the firms which have the plans.

A second major shortcoming of employer-initiated pension schemes is that they may be abandoned at the will of the employer, leaving the employe without protection. Of 418 plans in existence in 1929, forty-five had been abandoned by 1932.

A third major defect of most employer-initiated pension schemes is that they restrict the movement of workers—a man who leaves one employer to work for another does not ordinarily carry his pension rights with him.

A fourth major defect is the handicap they put on older workers in finding employment. This deficiency is a result of the third one, namely, that employes do not carry their pension rights from one employer to another. Even twenty years' contributions on behalf of a worker will not buy him a very adequate pension unless these contributions are at a high rate. Consequently, a man who is hired at the age of 55 and retired at the age of 65 or 68 would receive a very small pension. Managements do not care to undermine the morale of their workers by giving substandard pensions to employes who are retired, and they avoid this difficulty simply by not taking workers of more than about 45 years of age except for temporary jobs.

2. UNION-NEGOTIATED PLANS

Pension plans negotiated by unions with employers may be less easily abandoned than an employer-initiated plan and they may cover a larger proportion of the employes, but they suffer from the same four major defects as do employer-initiated plans. Consequently, it was a

blunder for the fact-finding board in the steel dispute to recommend union-negotiated plans for the various steel companies.

Union-negotiated plans will never give adequate coverage, partly because they do not apply to the self-employed and partly because they can be instituted only in those plants where the employer is making enough money so that he can grant the union demand for pensions, meet the large accrued liability, and hold his own in competition. No matter how strong the union, it cannot impose an adequate pension plan on those employers who are financially weak. The limitation of coverage is especially great when the cost of pensions falls entirely on the employer. Consequently, if union-negotiated plans are established, the workers should contribute part of the cost.

The union-negotiated pension plans which have been established thus far do not, as a rule, permit an employe who leaves an enterprise to carry his pension rights with him to his next job—though some of the stronger unions may be able to correct this defect by negotiating changes in the plans. Union-negotiated pension plans, like employer-initiated plans, discourage employers from hiring older workers and thus handicap older workers in finding jobs.

A special drawback of many union-negotiated pension plans is their financial unsoundness. Many of these plans make no provision for meeting the huge accrued liability with which the plans start. In many cases the cost of the pensions in a decade or so will be so large that the unions will have to consent to a reduction in the pensions in order to gain wage increases. Consequently, the so-called "security" offered by many union-negotiated pension plans is illusory.

The pension fund in the coal industry is a glaring example of an arrangement which provides illusory security because it is financially unsound. No adequate provision has been made to finance the enormous accrued liability with which the scheme started. Nor has the underwriting of the risks been arranged to assure that any part of the payments now being made into the fund will be available to provide pensions ten or twenty years hence for the men who are today counting on getting pensions when they retire. An insurance company which attempted to operate as the miners' welfare fund is being operated would quickly be in trouble with the law.

3. OLD-AGE ASSISTANCE

The old-age assistance program of the Federal Government is the largest single source of income to retired persons. About 2.6 million are drawing old-age assistance, and total old-age assistance payments are roughly twice as large as all of the pension payments made under the

Federal old-age pension scheme. More than half of the money now disbursed for old-age assistance comes from the Federal Government, but administration is in the hands of the states.

The old-age assistance program is open to two major objections. One is that it is demoralizing and the other is that it opens the door to grave political abuses. It is demoralizing for people to have to accept charity after a lifetime of work. And since the money comes from general revenues, recipients of aid do not have the satisfaction of knowing that they have made a specific contribution to help finance the payments which they receive.

The fact that payments are based upon a means test makes the plan difficult to administer. Need is difficult to define, and this creates the danger of political favoritism. The danger is aggravated by the fact that payments are made out of general revenue and that most of the states, which administer the scheme, are paying out more Federal money than state money.

During the last ten years the record of old-age assistance strongly suggests that such a scheme cannot be satisfactorily administered. Although unemployment (which tends to be especially high among older persons) dropped from 9.5 million in 1939 to 2.1 million in 1948, payments for old-age assistance increased 2.7 times. There are wide differences between states in the proportion of persons receiving aid, and there are wide variations in average monthly payments even between adjoining states. . . .

Wide variation also occurs in the size of payments. . . .

4. OLD-AGE INSURANCE

The most satisfactory arrangement for providing income for retired persons is the Federal old-age insurance plan. It avoids the principal weaknesses of the other three schemes. In the first place, it is comprehensive, for it covers all jobs in all plants within the covered industries. It is not limited to the generous and prosperous employers or to the plants where unions are strong. In the second place, it gives enduring protection because it cannot be abrogated at the will of an employer, and employes do not lose their pension rights if their employer goes out of business. In the third place, since employes carry their pension rights with them, the plan does not deter employers from hiring older workers.

In the fourth place, the burden of financially weak employers is limited by the fact that the plan applies alike to all competitors in an industry, by the fact that the accrued liability is met very gradually (as is possible only under a compulsory system), and by the fact that half of the cost falls on employes. In the fifth place, the self-respect of

the workers is protected because pensions are given as a matter of right without a means test and are financed, not from general revenues, but from a payroll tax to which both employes and employers contribute equally. Finally, the fact that pensions are paid as a matter of right eliminates the chance for political favoritism.

Although the Federal old-age insurance scheme is basically sound, it has three serious defects—its coverage is inadequate, its eligibility requirements are too strict, and the benefit payments are too low. The coverage is inadequate because the plan does not cover certain important types of workers, such as domestic servants, employes of non-profit institutions, farm employes and the self-employed. All in all, it covers about three out of five jobs. The eligibility requirements are too strict—it takes too long for workers to acquire insured status. As a result, only about one out of five persons of 65 years of age or more is drawing pension benefits or has insured status under the plan. The low benefit payments are indicated by the fact that the average payment for single workers is about $26 a month and for a worker with one dependent, about $40 a month.

The House of Representatives on Oct. 5 passed a bill, H. R. 6,000, which would make substantial improvements in the old-age insurance scheme. The bill would extend the coverage of the act to include nearly one million out of three million domestic service employes, about 200,000 farm laborers, and about 4.5 million urban self-employed. It would extend partial protection, and possibly complete protection, to about 600,000 employes of non-profit institutions.

By voluntary agreement between state governments and the Federal Government, about 3.8 million employes of state and local governments might be covered. The bill would liberalize the eligibility requirements so that newly covered employes would become insured more quickly. Finally, it would raise benefit payments about 70 per cent to an average of between $50 and $60 a month. [Note: Public Law 734 was passed in the House 333 to 14 and in the Senate 81 to 2.]

The provisions of the bill just passed by the House, though a long step in advance, fall short of the recommendations of the Advisory Council on Social Security appointed two years ago by the Finance Committee of the Senate. This body consisted of seventeen members—six business men, two representatives of organized labor, four persons from the public service, and five persons from university work and scientific research. The council was unanimous in recommending that coverage of the old-age and survivors' insurance be made virtually universal.

For example, the council would cover farmers and professional workers who would not be covered under the recommendations of the

Ways and Means Committee. The council was also unanimous in recommending that eligibility requirements be changed so as to permit workers to qualify more promptly for pensions. The council also recommended increases in benefits which would raise the average benefit of a retired worker without dependents from $26 a month to $55 and of a worker with a wife from $40 to $85 a month.

The Federal old-age pension plan, if its coverage were extended to nearly all of the 25 million uncovered jobs and if the average benefits were substantially raised, would provide the country with an adequate plan of old-age security and would limit the dependence of the country upon unsound employer-initiated or union-negotiated plans which tend to tie the worker to one employer and which handicap older workers in obtaining employment.

A comprehensive and adequate old-age insurance plan is the only way of checking the rapidly snowballing old-age assistance payments. The usefulness of the Federal old-age pension plan in relieving the community of dependence on unsound alternative arrangements will depend upon adequacy of benefit payments. Surely it is not unreasonable that the pension of a man with a wife to support should be at least half of his earnings before retirement. In the case of a man who had been earning $300 a month throughout his working life, the recommendations of the Advisory Council would result in a monthly pension of $106.87—a little more than one-third of his monthly earnings.

Although the Federal old-age pension plan can be easily developed to provide adequate protection to retired workers, some employers and some unions may wish to establish supplementary plans. The Federal Government, however, has an obligation to see that supplementary plans really provide the security which they promise, that they do not tie a worker to a given employer, and that they do not encourage employers to discriminate against older workers.

This can be done by requiring that the plans meet certain standards in order for employer contributions to be a deductible expense under the corporate income tax law. These standards should require that the plan be properly underwritten and that the employes who leave the service of an employer take their pension rights with them. In addition, in order to avoid encouraging noncontributory plans in preference to contributory, the Federal Government should permit the contributions of employes to pension plans to be a deductible expenditure under the personal income tax—at least if the employe's contribution is matched by one from his employer.

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Can the country afford an adequate scheme of security for old age?

With stiff wage demands constantly being made on industry, with large quantities of goods needed for national defense and to provide help to sixteen countries in Europe, can industry produce enough to give decent pensions to retired workers? And are not all schemes by which the community undertakes to provide security for retired workers wrong in principle? Are not such schemes bound to undermine thrift, initiative, self-reliance, and the spirit of independence?

The cost of an old-age pension plan paying benefits moderately more liberal than those included in the bill recently passed by the House or recommended by the Advisory Council on Social Security may be put roughly at 8 per cent of payrolls. In the past, output per man-hour in the United States has increased about 2 per cent a year. If it continues to grow at the rate of 2 per cent a year, it will increase by over 80 per cent in the next thirty years.

Hence, the total cost of a fairly adequate old-age security program would be about one-tenth the increase in production during the next generation—assuming that output per man-hour grows no faster than in the past. The one thing that must be avoided, in order to keep the cost of old-age security within moderate limits, is a further drop in the usual age of retirement. Universal retirement at 65, depriving the community of nearly $11 billion of product a year, would be ten times as costly as the present old-age pension program is today.

The danger that a system of old-age security will undermine thrift is remote. The usual method by which men have provided for their old age has never been thrift—it has been by having plenty of children and expecting the children to help the parents. Certainly pensions which pay 50 per cent more or less than average earnings leave much room for thrift. Furthermore, no one need fear that the incentives to practice thrift are about to disappear—there are many good things which the ordinary person can acquire only by practicing thrift quite rigorously. Any wage-earner who buys a house at present prices will have a good opportunity to be thrifty for years to come.

Nor is old-age security likely to undermine initiative, self-reliance and independence—it is likely to strengthen these qualities. The reason is obvious. The worker, small-business man or high executive who has a minimum of protection for his old age is likely to be willing to take some economic chances which he would not otherwise dare take. The extension of old-age security to small-business men may be particularly useful in making them feel better able to take risks. Certainly if the prospect of a pension is likely to undermine initiative or self-reliance, this probability has been overlooked by the many corporations which have provided generous noncontributory pensions for their executives —the very men who most of all need to have initiative and self-reliance.

One final word of warning. The greatest danger to an adequate old-age security plan is rising prices. A rise of 2 per cent a year in prices would cut the purchasing power of pensions about 45 per cent in thirty years. The greatest danger of rising prices is from wages rising faster than output per man-hour. If unions put up money wages 5 per cent a year and output per man-hour increases 3 per cent a year, prices will have to rise by the difference, or 2 per cent a year. Hence, whether the nation succeeds in providing adequate security for retired workers depends in large measure upon the wage policies of trade unions. If unions push up wages faster than output increases, they undermine the security of all retired workers.

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VOLUNTARISM

T. N. CARVER

[William Graham Sumner identified the *Forgotten Man* in the following words:]

"The man who has done nothing to raise himself above poverty finds that the social doctors flock about him, bringing the capital which they have collected from the other class, and promising him the aid of the state to give him what the other had to work for. In all these schemes . . . the state is thus made to become the protector and guardian of certain classes. The agents who are to direct the state action are, of course, the reformers and philanthropists. Their schemes, therefore, may always be reduced to this type—THAT A AND B DECIDE WHAT C SHALL DO FOR D. . . . In all the discussions attention is concentrated on A and B, the noble social reformers, and on D, the 'poor' man.

I CALL C THE FORGOTTEN MAN

because I have never seen any notice taken of him in any of the discussions. When we have disposed of A, B, and D we can better appreciate the case of C, and I think that we shall find that he deserves our attention for the worth of his character and the magnitude of his unmerited burdens. Here it may suffice to observe that, on the theory of the social philosophers . . . we should get a new maxim of judicious living: Poverty is the best policy. If you get wealth, you will have to support other people; if you do not get wealth, it will be the duty of the other people to support you.

"It is the Forgotten Man who is threatened by every extension of the paternal theory of government. It is he who must WORK and PAY. When, therefore, the statesmen and social philosophers sit down to think what the state can do and ought to do, they really mean to decide WHAT THE FORGOTTEN MAN SHALL DO." [*What Social Classes Owe to Each Other,* Harper and Brothers, 1883.]

. . . the writer is moved to say a few kind words about our Economic System. There is so much dissatisfaction with it, because of the depression, and so many harsh things are being said about it, that it is likely to be condemned without a real hearing. This danger is increased by the fact that radicals read only radical books and conservatives don't read any—except for entertainment and culture.

Our economic system is essentially a voluntary system under which men work together on the basis of voluntary agreement, or contract, rather than on the basis of coercion, or the authority of the few and the obedience of the many.

It is not essentially a system of competition, though competition will exist under any voluntary system; of laissez faire, though within the field of useful work, men are let alone; of private property, though private property will exist in any voluntary system; of capitalism, though capitalism will exist in the absence of coercion; of markets, though markets will exist wherever men are free to buy and sell; of profits, though profits will exist wherever men are free to work for themselves.

Voluntarism is more fundamental than any of the above-named characteristics of our system, since they all depend for their existence upon freedom from violence, freedom to work together by voluntary agreement, freedom to own, to buy and sell, and to enjoy what one has produced or purchased.

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Economic Voluntarism is in danger. Its enemies are well organized and aggressive. Some well-meaning people are thoughtlessly aiding them.

The enemies of our system exaggerate the defects in its operation. These defects are not inherent in the system. They are evils which have grown up under it and can be remedied. Until they are remedied they will be used as grounds of attack. They also create discontent to which its enemies will appeal.

The friends of our system are apathetic. They must be aroused, not only to defend the system, but also to remedy the evils which make it vulnerable.

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Economic voluntarism is worth preserving. It assures both liberty and abundance—two good things. It does not ask men to surrender liberty in order to receive rations under a coercive system, nor to surrender abundance in order to retain liberty. It insures greater abundance than any other system can give and it gives men freedom, which any coercive system would destroy.

Men who are comfortable under voluntarism have everything to lose if it is destroyed. Men who have not yet achieved a comfortable position have more to gain from the improvement of our system than from a new and untried coercive system.

Both classes should work to retain and to improve the voluntary system.

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The danger to economic voluntarism is due solely to the existence of mass poverty. . . . Mass poverty can be cured under economic voluntarism.

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The abolition of mass poverty is an ambition noble enough to fire the imagination of a great nation. If America succeeds in blotting out this disgrace to modern civilization, it will be a unique achievement, and not an attempt to imitate what other nations have already done. Nothing like it has ever been accomplished or even intelligently attempted.

Suppose we were to equal the Greeks or the Italians in their magnificent achievements. That would be something to be proud of, but after all, we should only be imitating what others have done.

Suppose we were to equal Europe of the thirteenth century in

religious fervor and religious art. That also, while a great achievement, would only be an imitation of what has been done before.

But if we abolish poverty that will not be an imitation; it will be something new.

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WHAT PRIVATE ASSOCIATIONS CAN SURVIVE IN A WELFARE STATE?

DONALD R. RICHBERG

WHAT IS CALLED the Welfare State may be defined as a government which assumes the direct and unlimited responsibility of assuring to all citizens a decent livelihood and financial security against the hardships that may result from unemployment, ill health, disability or old age. Such a responsibility cannot be met without giving to the government power to plan to control the operation of all productive enterprises and the distribution of all income and products in conformity with government requirements. In such a Welfare State the function of all private associations which are engaged in, or affect, production or distribution must be to act as instruments or agencies of the government in meeting its assumed responsibility.

Even those who oppose the development of such a Welfare State ought to concede that it *is* the responsibility of our government to establish an adequate legal structure for a Society of men and women, who are living and working together for mutual protection and correlative gains. But, this legal structure should be an authentic House of Voluntary Cooperation in which citizens can organize and operate voluntary associations through which the opportunity to earn a decent livelihood and to gain financial security against hardships will be

assured. The opponents of the compulsory Welfare State (a few million surviving "libertarians"!) believe that when political force is used to *compel* men to associate, and to operate their associations, in conformity with political programs, then the inherent vigor of a free people and a free economy is destroyed. They believe that our material progress will be retarded by this loss of vigor far more than it can be advanced by the disciplinary efficiency of compulsory cooperation. They are sure that our spiritual progress will become a spiritual retreat.

A good example of the two opposing concepts of government is found in the choice between government *protection* and government *control* of labor organizations. It has been our governmental policy for many years to protect labor unions from destruction by, or subservience to, the economic power of large employers. In order to promote an equality of bargaining power labor unions have been aided by law to organize wage-earners in such numbers that they could confront employers with a choice between paying good wages or being unable to operate their properties.

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If, however, the government should assume an unlimited and direct responsibility for the wage-earner's livelihood and security, government wage fixing would become a continuing and imperative duty. Then the fixing of a wage for any important group of workers would require the equalization of wages for all other groups, and, inevitably, the determination of reasonable prices for consumers and of reasonable compensation for the owners of properties which are used to provide employment or shelter or services for the workers.

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Indeed the inevitable march of political control is now clearly forecast in the recent official proposal of our nascent Welfare State to guarantee an income to farmers. But, what value would a guaranteed income have for farmers if there were no accompanying guarantee of the purchasing power of that income? How can a farmer's buying power be guaranteed unless there is a control of the prices which a farmer must pay for what he buys? How can industrial prices be controlled without a control of industrial labor?

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Of course there is no fair comparison between the cruelly enslaved labor of Russia and gently "directed" labor of Britain. It would be silly to prophesy that an American Welfare State would promptly enslave

the industrial workers and the farmers who voted it into power. . . . But, it is even more silly to contend that a Welfare State can fulfill its promises, and guarantee a decent livelihood and financial security against hardship to all able-bodied citizens, without exercising a supreme authority to plan and direct the operation of all major industries and to determine the proper compensation and working conditions for all essential workers.

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The reason that there is no such candor, no such fundamental honesty, in the Welfare State program is that, when clearly explained, it becomes evident that the nascent Welfare State must become eventually a State of National Socialism, or else engulf us in the most calamitous depression of our history. . . .

To make it plain why a Welfare State must become totalitarian or become insolvent, it is only necessary to reveal exactly how our government has been able to carry the enormous load of its present expenditures. The man-in-the-street is unwilling or unable to analyze this fiscal problem. But no student or teacher of political science can shun the tiresome task.

. . . To shorten the present discussion I will now offer only a few conclusions:

1. We have devalued the dollar, borrowed over 200 billion dollars and in various other ways inflated our national income in *dollars* to 2½ times what it was twenty years ago.

2. We have increased taxes and federal expenditures from $31.60 per person in 1929 to $268.23 per person in 1948.

3. In addition to payments for national defense and interest on debt the national government is expending about 25 billion dollars per year for the general welfare of ourselves and other people. . . .

4. The *introductory* program for a Welfare State which the President brought forward this year will add another 25 billion dollars to annual national expenditures. This calculation was made by the staff of the Senate Committee on Expenditures in the Executive Departments; and was reported to the Senate by the committee chairman, Senator McClellan. He estimated that the *increase* in the tax burden to pay for this initial program would be $166 annually for every man, woman and child in the United States; and that *total* federal taxes would then amount to 30 per cent of present national income.

5. If we add state and local taxes to the federal, this would "make the annual tax obligation of the American people more than 40 cents out of every dollar they earn."

6. The major part of all taxes are, and must be, paid by persons of small or moderate incomes.

7. As the voters become too much exhausted or exasperated by increased direct taxation of incomes, political spenders resort more and more to indirect taxes, concerning which millions of people are either ignorant or strangely indifferent. The indirect taxes paid today by the average family have been carefully computed to exceed $700 per year. When direct taxes on small incomes are added, it becomes a proven fact that the average wage-earner's family is already paying over $1000 a year for the support of an infant Welfare State that has only just begun to bite!

Any competent student of the fiscal and operating problems of the infant Welfare State must see that, with the development of its vast public projects, taxation will become so confiscatory, the regulation of management and labor so detailed, private property rights so reduced, and private enterprise so smothered by political controls, that the emergence of the mature Welfare State as a State of National Socialism is inevitable.

Apparently the concealed justification for taxing people so that the government may spend their individual earnings to advance their individual welfare is that the masses of the people are morons who should not be trusted to spend their own money. It is assumed that they should be glad to have their money spent for them by professional politicians trained and experienced in the art of spending other people's money. . . . Business men are pictured as cold, greedy, fat exploiters, while politicians are those genial backslappers who call you by your first name and work day and night to find ways to buy things for you with your money which you wouldn't buy for yourself.

There are many things of common use which may wisely be paid for through government, such as roads and parks and common school facilities. But the Welfare State proposes to take more and more of a man's earnings to buy things for his *individual* use which he ought to be free to buy less or more of according to his individual need or desire. It proposes to substitute a common standard of living and a common, compulsory pursuit of happiness for the individual rewards and the individual pursuit of happiness which have inspired the American people to raise themselves through voluntary cooperative enterprises to the highest standard of living, coupled with the greatest individual liberty, ever enjoyed by 150 million human beings.

But, why shouldn't you buy your own health insurance, or any other insurance against misfortune, from your own selected insurance organization? Millions upon millions of people have done it. Why

shouldn't you organize voluntary cooperatives to buy and sell things for you? Millions of people all over the world have done it. Why shouldn't you use your own labor organizations to provide unemployment insurance either alone or in cooperation with employers? Labor unions can pay strike benefits when men refuse to work; why should they not pay unemployment benefits when men are unable to find work?

The point which I am trying to make briefly is that the major offerings of a Welfare State are simply offerings to do for you what you can do better, more cheaply and with greater satisfaction, for yourself. In so doing you can save yourself from dependency on political favor, political integrity and political wisdom, those three weak reeds upon which no man who has common sense and a knowledge of history will ever wish to become dependent. Three weak reeds upon which no man who has a backbone of self-reliance will be willing to lean.

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Furthermore, it should be accepted that, in the emergencies of war, national disaster, or serious economic disorder, the government should take such action as is temporarily necessary to develop and make effective the maximum power of our nationally organized resources to meet the emergency demands upon them. But, it should be our established doctrine that such political controls of our lives and work are fundamentally evil, like fighting fire with fire and bullets with bullets. We should make it an everlasting rule to end political tyranny and denials of individual liberty just as soon as the emergent calamity that enslaves us has been overcome.

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There are two major excuses for substituting political support for self-support, and political discipline for self-discipline, which merit brief discussion.

One is the excuse that because some men make too much money out of others, they should be compelled by taxation to share their gains with those whom they exploit; or, because some localities are more prosperous, their gains should be shared with poorer localities. Let us disregard the counter-argument that the forced service of the more competent to the less competent, and the levelling down of humanity to a common standard of living, is not a democratic but a communistic doctrine. Nevertheless, we may well agree that the exceptional profits of fortunate individuals or favored communities should be taxed away to maintain the common defense and to promote the general welfare.

But, it is a proven fact that if every dollar of income in excess of a fair compensation for personal services, or for the use of private properties, were siphoned into the United States Treasury, this would provide only part of the federal revenue needed to pay for national defense, national administration of justice and national expenditures for public works of general value. A major part of all essential public revenues must be obtained by a direct or indirect tax deduction from the earnings of the great mass of workers of small or moderate incomes. So the revenues of the expanding Welfare State will necessarily come from increased deductions from the earnings of those who are the proclaimed beneficiaries of this additional government spending.

The second excuse for a paternal collection and spending of a worker's earnings, is that voluntary cooperation will fail to advance the welfare of the cooperators as far as compulsory cooperation would. It is argued that the thriftless or unfortunate who most need protection, will not or cannot insure themselves. It is also argued that in any industry a chiseling minority will break down the best devised programs for preserving an ideal balance between producing and consuming power. As one of the administrators of the notable NRA experiment, I am familiar with these arguments and believe that I can appraise their merits with the aid of an unusual amount of experience and with, perhaps, an unusual impartiality of judgment. I still believe in the voluntary self-government of industry, which was the announced objective of the NRA. I never believed in the compulsory political government of industry which NRA dabbled in, while floundering down the road to Limbo.

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Once upon a time it was the supreme law of our land that there was no "due process of law" by which our national government could deprive a man of the liberty to support and protect himself and his dependents by his free labor and his free use of his own earnings. The government could only tax him to support the strictly limited powers of the government to provide for the common defense and the *general* welfare. It could not tax him to enable the government to take care of his *individual* welfare or the *individual* welfare of his neighbors. It could not deprive him of his "unalienable right" to take care of himself, or to make a fool of himself.

But, today, following the socialist dogma that the individual citizen should be made the bond servant of the general welfare, the courts have invented a new "due process of law" with which the national government can deprive a farmer of the right to raise grain on his own land

for his own consumption, unless he obeys government orders limiting the amount of grain he can raise and fixing the prices at which he can sell it. Today, the national government, by using this new "due process of law," can deprive a worker of the right to spend, to save and invest his own earnings as he wishes, for the economic support and protection of himself and his family. He can now be compelled to pay taxes which transfer a substantial part of his earnings to the government so that it can then provide such economic protection for him and for others as the government decides to be in the interest of the general welfare.

If ten to twenty per cent of a man's subsistence earnings can be taken from him today there is no legal barrier against taking from him thirty to forty per cent tomorrow, which, according to British precedents, will be required to support a young Welfare State. In such a political economy, of what use will be private, voluntary associations, except to serve as pressure groups to try to elect and control public officials so that, in the political distribution of a worker's earnings, he may get back as much as possible after paying a few million political employees for spending his money for him?

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Here is a summary answer to the question presented for this discussion: Private, voluntary associations, as an influential factor in our political economy, will not and cannot survive in a compulsory Welfare State. Their powerful influence in the expansion and enrichment of our American way of life will disappear in the politically planned and directed economy of National Socialism.

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THE RISE OF THE SERVICE STATE AND ITS CONSEQUENCES

ROSCOE POUND

THE SERVICE STATE, the state which, instead of preserving peace and order and employing itself with maintaining the general security, takes the whole domain of human welfare for its province and would solve all economic and social ills through its administrative activities, has been creeping up on us in the present century. . . . It was known earlier in Continental Europe. But although some writers in England were calling attention to its possibilities at the end of the last century, it was so at outs with ingrained modes of Anglo-American thought that few tried to put the pieces of evidence together to see what is indicated as to the direction in which we have been moving. In the meantime, since the first world war, it has made exceedingly rapid progress and has covered already a very wide field of individual activity and of official promotion of wide welfare programs on every side.

I say service state rather than welfare state. The term welfare state seems to me a boast. Governments have always held that they were set up to promote and conserve public welfare. This is implicit in the synonym commonwealth—the common weal or general welfare personified in the state. So far men have agreed. But when it comes to the question how the common weal or general welfare is to be achieved, they have differed and do differ profoundly. Some think the general welfare is best promoted by a government which maintains order and administers justice, for the rest, leaving men free to do things for themselves in their own way so far as they do not commit aggressions upon others or subject others to unreasonable risk of injury, and act in good faith in their intercourse with others. On the other hand, there have always been those who have believed in a benevolent government

which helps men instead of leaving them free to help themselves; who have believed in a paternal ruler or paternal state doing things for his subjects or its citizens to the fullest extent.

Understand, I am not preaching against a service state in itself. The society of today demands services beyond those in the state, which only maintained order and repaired injuries, could perform. In a complex industrial society it becomes more difficult to do by private initiative many things which the public wishes done and wishes done quickly. Administrative agencies of promoting the general welfare have come to be a necessity and have come to stay. It would be futile to quarrel with the idea of a service state kept in balance with the idea of individual spontaneous initiative characteristic of the American. What one must resist is not state performance of many public services which it can perform without upsetting our legal, political, economic and social order, but the idea that all public services must and can only be performed by the government—that politically organized society and that alone is to be looked to for everything, and that there is no limit to the services to humanity which it can perform. What I deprecate is carrying to the extreme the idea of regimented co-operation for the general welfare; the exaltation of politically organized society to the position of an absolute ruler. This presupposes supermen administrators or an all-wise majority or plurality, omnicompetent and equal to taking over the whole domain of the general welfare and to determine in detail what it calls for in every situation. The service state in the English-speaking world began by performing a few major additional services beyond maintaining order and administering justice. As it has added more and more it has come to be jealous of public service performed by anyone else.

What is to be the effect of the service state upon American constitutional democracy? The service state as it develops as a super-service state must be *par excellence* a bureau state. From the very nature of administration the bureau state calls for a highly organized official hierarchy. A hierarchy calls for a superman (very likely an *ex officio* superman) at its head. Thus, unless we are vigilant, the service state may lead to a totalitarian state. It has Marxian socialism and absolute government in its pedigree and has grown up along with the totalitarian state in other parts of the world. Liberty—free individual self-assertion, individual initiative and self-help—is looked on with suspicion if not aversion by the service state, and its advocates seek a "new concept of liberty" as freedom from want and freedom from fear, not freedom of self-assertion, or self-determination. Self-help by the individual, competing with the service rendered by the state, seems an interference with

the regime maintained by the government. Spontaneous individual initiative is frowned on as infringing on the domain of state action. The service state easily becomes an omnicompetent state with bureaus of *ex officio* experts and propaganda activities carried on at public expense. If the step to it is gradual, the step from it to an absolute state is easy and may be made quickly.

Bills of rights are a characteristic feature of American constitutions. Beginning with the Virginia Bill of Rights of 1776, enacted immediately after the Declaration of Independence, they have been made a part of all our constitutions, state and federal. Our American bills of rights are prohibitions of governmental action infringing guaranteed rights, that is, guaranteed reasonable expectations involved in life in civilized society. They are laws, part of the constitution as the supreme law of the land, enforceable in legal proceedings in the courts at suit of those whose rights are infringed. They are generally distinct from the declarations of rights on the model of the French Declaration of the Rights of Man which are to be found in constitutions generally outside the English-speaking world. Those are mere preachments, declarations of good intentions or exhortations to governmental authority, legally binding on nobody and unenforceable by anyone whose declared rights are infringed. But the service state is beginning to affect our conception of a bill of rights in America. In a recent proposal for a declaration of rights for a world government we get the Continental note in the very title, but also the note of the service state which is disinclined toward law. There is a declaration of a right of everyone everywhere to claim for himself "release from the bondage of poverty." It is not that he is to be free to free himself from his bondage, but that the state is to free him without his active help in the process. Also he is declared to have a right to claim reward and security according to his needs. But his claim to needs is likely to have few limits and is sure to conflict with claims of others to like needs. Such declarations are not merely preachments, not enforceable or intended to be enforced as law, they are invitations to plundering by rapacious majorities or pluralities.

In a recent book, Professor Corwin has discussed the decadence of fear of oppression by government which has become very marked. Experience of government in seventeenth-century England and experience of government of the colonies from Westminster in the seventeenth and eighteenth centuries had made this fear a dominant consideration in our policy from the beginning till well into the present century. Growth of a feeling of divine right of majorities, akin to that of divine right of kings, has led to an assumption that concern about oppression by government is something we have outgrown. Yet dis-

trust of absolute majority or absolute plurality is as justified in reason and in experience as distrust of the absolute personal ruler. Indeed, the latter may be given pause by fear of an uprising which an intrenched majority need not fear.

It is characteristic of the service state to make lavish promises of satisfying desires which it calls rights. If a constitution promises to every individual "just terms of leisure," those who draft it do not ask themselves whether such provision is a law, a part of the supreme law of the land, or a preachment of policy which no court can enforce and no legislative body can be made to regard. Such preachings enfeeble a whole constitutional structure. As they cannot be enforced, they lend themselves to a doctrine that constitutional provisions are not legally enforceable and may be disregarded at any time in the interest of political policy of the moment. They weaken the constitutional polity we have built up. Is there wealth enough in the world reachable by taxation imposed by a world government, or even reachable by wholesale confiscation by a world state, to guarantee "just terms of leisure" during life to the whole population of the world or even to four hundred and fifty million Chinese?

Setting forth such things in a constitutional declaration of guaranteed rights makes a farce of constitutions. How can a government release the whole world "from the bondage of poverty"? What organ of government can be made to bring about that enough is produced and is continuously produced to insure plenty for everyone everywhere? How can a court compel legislative or executive or individuals or organizations of individuals to bring this about or how can executive or legislative compel either or anyone else to do it? Such pronouncements proceed upon a theory which used to be preached by social workers that law is a protest against wrong. Protests against wrong may be very effective in spurring lawmakers to find remedies and enact laws making them effective. But protests themselves lack the quality of enforceability and machinery of enforcement which are demanded for a law in any advanced society. . . .

A power to act toward a general equality of satisfaction of wants and a policy of developing such an equality are something very different from a provision in a declaration of rights that a world government guarantees to bring such a policy to fruition. No one can seriously believe that in such time as we can foresee the western world can provide complete social security for the rest of the world, a great part of which is always close to the brink of starvation.

I have spoken at some length of proposals for declarations of rights for a world political organization because the propositions drafted by

enthusiastic promoters of a world constitution are followed sometimes in recent proposals for constitution writing in the development of the service state in America. A state which endeavors to relieve its people of want and fear without being able to relieve its individual citizens of the many features of human make-up which lead to poverty and fear is attempting what the colored preacher aptly called unscrewing the inscrutable. How can we expect a state to bring about a complete satisfaction of all the wants of everybody in a world in which we all want the earth, but there are thousands of millions of us and only one earth. Guarantees which are no more than promissory declarations of policy can do no more than deceive. Some years ago, when in one of our states a "modern code" was being urged and propositions for promissory declarations for wide amelioration of human ills were presented, a wise and experienced lawyer suggested that one additional article would make the whole perfect: Be good and you will be happy. Hell is paved with good intentions. An extensive pavement of that material is far from a solid foundation for a politically organized society. The service state is a politically organized society and cannot, as could Baron Munchausen, pull itself up by its own long whiskers. This does not mean, however, that our nineteenth-century bills of rights cannot be supplemented to meet conditions of the urban industrial society of today.

The two new articles in the bill of rights of the New Jersey Constitution of 1947, articles 5 and 19, directed to questions of segregation and discrimination on grounds of race, color or creed and to rights of organization and collective bargaining are models of what may be done by constitutional provisions, part of the effective law of the land, enforceable and meant to be enforced, as compared with preachments and promises and wishful declarations of ideal policy.

Promissory bills of rights creating expectations of the politically and economically unachievable and weakening faith in constitutions are a step toward the totalitarian state. The strong selling point of that state is its argument that a strong man, a superman leader, can do what a government hindered by constitutional checks and balances cannot do. When a constitution declares rights as claims to be secured by government which it can't secure, it invites centralization of power in an absolute government which claims ability to secure them. The service state, taking over all functions of public service, operating through bureaus with wide powers and little practical restriction on their powers, through government positions for a large and increasing proportion of the population, and through systematic official propaganda and a system of subsidies to education, science and research, can

easily be taking strides toward an absolute government, although under forms of democracy. Indeed, the extreme advocates of the service state insist that constitutional democracy is a contradiction in terms. A democracy must be an unrestricted rule of the majority. The majority must be as absolute a ruler in all things as was the French king of the old regime in France or the Czar in the old regime in Russia. As the seventeenth century argued that a monarchy must in the nature of things be an absolute not a constitutional monarchy, on the same logical grounds it is argued that a democracy must be an absolute not a constitutional democracy.

General welfare service by the state, becoming service for strong aggressive groups or for politically powerful localities at the expense of the public at large, has been the ladder by which absolute rulers have climbed to power and the platform on which they have been able to stay in power. Louis XIV held down France by holding down Paris by distribution of bread at the expense of the provinces. The Spanish absolute monarchy long held itself in power by using the wealth of the New World for service to its subjects at home. Napoleon III used state workshops. Totalitarian Italy used the theory of the service of the corporative state. Totalitarian Russia promises proletariat rule at the expense of the rest of the community. Indeed, in antiquity the Roman emperor held down Italy by extortion of wheat from Egypt.

Since the first world war we have preached a great deal and promised much as to the rights of minorities and of oppressed racial groups. But the lavish promises and administrative absolutism of the super-service state (or shall we say service super-state?) with the absolute ultimate rule of majorities or even of pluralities which they involve, are a menace to the guarantees that a constitution which is a legal document, not merely a frame of government promising welfare services which it cannot be made to perform, is able to give those groups. The attempt to make all men equal in all respects instead of in their political and legal rights and capacities, is likely to make them more unequal than nature has done already. Unless we give equality the practical meaning of our American bills of rights, we are likely to be thrown back to a proposition that all men are not born equal but are born equally.

There has been a tendency of men in all history to worship their rulers. In the society of today this takes the form of faith in absolute rule of the majority or, indeed, of the plurality for the time being. We forget that majority or plurality are only a way out when we cannot get entire agreement. The founders of our polity, with long and bitter experience of absolute rule behind them, sought a govern-

ment of checks and balances by which absolute rule by any one was precluded. As Mr. Justice Miller put it, in the centennial year of the American Revolution, the theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. Today we are told that this doctrine is outmoded. What called for the pronouncement was legislation imposing a tax for subsidy to private manufacturing enterprise. That was regarded as unconstitutional in 1875. But in the service state of today expensive service to some at the cost of others is regarded as a service to the public, as indeed it may be in some cases, and this tempts aggressive groups to obtain legislation providing service to them for which others must pay. A group of the sort easily in its own mind identifies itself with the public. Obviously the conception of public service needs to be carefully defined and limited if we are to avoid being led into absolute rule by majority or plurality.

A government which regards itself as, under pretext of extending a general welfare service to the public, entitled to rob Peter to pay Paul, and is free from constitutional restraints upon legislation putting an element or group of the people for the whole, has a bad effect on the morale of the people. If government is a device for benevolent robbery, a would-be Robin Hood of today is not likely to see why his benevolently conceived activities are reprehensible. Based on colonial experience of legislation imposing burdens on some for the benefit of others rather than of the public, our older constitutions and substantially all constitutions in the nineteenth century forbade special or class legislation. The omission of this provision from recent constitutions is significant. No doubt the restriction in the nineteenth-century constitutions was applied too rigidly and was made to stand in the way of proper welfare legislation. But entire omission points to a feeling that government is intended to be unfair to minorities and that there should be no limit on the ability of organized groups to make their fellowmen pay for special service to them.

A service state must be bureaucratic. Bureaus are characteristically zealous to get everything in reach under their control. Would it be a great public service to have a bureau of psychologists to examine us for our aptitudes and assign us, whether we like it or not, to the calling for which they find us fitted? Before the advent of psychologists such a state was argued for by Greek philosophers. The later Eastern Roman Empire stabilized society by putting and keeping men in callings somewhat in this way. An omnicompetent state postulates omnicompetent bureaus. Why in the perfect all-regulating state allow human energy to be wasted by permitting individuals to engage in futile efforts to

employ themselves in callings in which they cannot succeed? Is not that the next move after subsidizing them to persist in these callings in which they are failing and bound to fail?

So much for the service state in its relation to our American constitutional polity. Now let us turn to the effect of the service state on the professions. By a profession we have meant, until the rise to prominence of the professional athlete obscured our ideas, a group of men pursuing a common calling as a learned art and as a public service—none the less a public service because it may incidentally be a means of livelihood. From the standpoint of a profession there are three ideas: A common calling, a learned art, and a spirit of public service. Gaining a livelihood is not a professional consideration. Indeed, the spirit of a profession, the spirit of a public service, constantly curbs the urges of that incident. An organized profession does not seek legislation relieving it of duties or liabilities incumbent upon it. It does not seek to advance the money-making feature of professional activity. It seeks rather to make as effective as possible its primary character of a public service. An engineer may patent his inventions. A manufacturer may get legal protection for his trade secret or patent his discovered process. What a member of a profession invents or discovers is not his property. It is at the service of the public.

A tradition of duty of the physician to the patient, to the medical profession, and to the public, a tradition of the duty of the lawyer to the client, to the profession, to the court, and to the public, authoritatively declared in codes of professional ethics, taught by precept and example, and made effective by the discipline of an organized profession, makes for effective service to the public such as could not be had from individual practitioners not bred to the tradition and motivated as in a trade primarily if not solely by quest of pecuniary gain. Nor can this professional tradition be replaced with benefit to the public by a political tradition of office holders owing primary allegiance to political parties and depending for advancement on the favor of political leaders. Moreover, the professional organization and tradition are even more to the public interest in their effect on the learned arts which the professions follow as callings.

All advance in science, in arts, in learning, in short, all progress in civilization—in the raising of human powers to their highest possibilities—is the result of trial and error, that is, of experimentation. Thus, every physician, every hospital, can and is impelled to experiment and invent, and as the professional spirit of public service leads to promulgation of the results of experiment and investigation and putting the results at the service of others, they are not individual trade secrets

and are not patented, and they do not need to be argued to bureaus nor do those who would use them have to await official adoption of them. They are open to free use and make their way on their intrinsic merit.

Huge bureaus of graduates of medical schools, brought up to seek public office, and organized in the civil service as employes of the service state, can be no effective substitute for a profession. With the multiplication of services rendered by the state comes a multiplication of officials; and ideas of official omnicompetence and majority infallibility come also. When every form of public service becomes at least potentially a state function, the difference between a public service performed by a profession and a public function performed by a bureau becomes crucial.

If callings have making of a livelihood for their primary concern, in an economic order in which the great majority of the community are on the payroll of either the government or of some corporation, public, public service, charitable, or private, it follows that most individuals will be in a sense employees and so liable to be caught up in a regime of employees' organizations, collective bargainings over wages, and strikes. Organization of physicians for advancement of medicine, organization of lawyers for advancement of justice, and organization of teachers for the advancement of teaching must give way to organization of employees of every grade and kind of employer for the advancement of wages and dictation of the conditions of employment. Already the two major labor organizations are carrying on a campaign to unionize the "white collar workers" in industry and business.

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Thus, as things are coming to be in an era of bigness, large scale organization of all activities, and strenuous acquisitive competitive self-assertion, the professional idea must contend with the rise to power of organizers of an expanding class of employees. Thus, more and more, as things are, as individuals in the professions have come to be regularly retained or nowadays regularly employed by great corporations, or appointed to substantially permanent positions under the federal government or state and municipal governments and administrative agencies, a constantly larger number of practitioners in their capacity of employees are enlisted in organizations with the trade spirit of emphasis on wages rather than the professional idea of pursuit of a calling in the spirit of public service. Unless we are vigilant it may well be that this prevailing of the trade idea will make straight

the path toward absorption of the professions in the service state. The course of that path is not hard to chart. We can see three possible stages: (1) Unionizing of all callings which may be taken to involve employment, at least so far as some in the calling are not capable of classification as employers; (2) by government subsidies getting control of professional education and thus subordinating the professions to bureaucratic management; (3) seeking to bring cheap professional assistance to everyone's back door by government taking over of the callings pursuing learned arts. Such a consummation may be pictured as a carrying of the idea of the service state to its furthest logical development. The service state began by performing a few major services. In time it has undertaken more and more. Now it has become jealous of public service being performed by any one else. The advocates of the omnicompetent state will say that in primitive or pioneer societies certain public services are rendered by any one who seeks to try his hand on the basis of such qualifications as he deems sufficient. Later, as society advances, such services are rendered by well qualified practitioners organized in professions, the qualifications, as these professions develop, being prescribed and ascertained by governmental authority. Ultimately, it will be said, as political organization of society reaches maturity, all public services of every sort are to be exclusive governmental functions to be exercised by government bureaus.

Very likely not all of those who are teaching or preaching the doctrine of the super-service state will, at the moment, admit this conclusion. But I submit that before we go far with them on the path in which they are marching we should pause to see whither it leads. As I said above, it should be remembered that the rise of the totalitarian state was coincident with the general reception of the idea of the service state and that both have Marxian socialism in their pedigree. Each in its way postulates an omnicompetent administration by supermen. If experience may be vouched, that means in the end supermen under the direction of an *ex officio* superman.

Even more the professional ideal is menaced by the development of great government bureaus and a movement to take over the arts as practiced by the professions and make them functions of the government to be exercised by its bureaus in a service state which may become a service super-state. For the idea of a profession is incompatible with its performance of its function, exercise of its art, by or under the supervision of a government bureau. A profession presupposes individuals free to pursue a learned art so as to make for the highest development of human powers. The individual servant of a government exercising under its supervision a calling managed by a

government bureau can be no substitute for the scientist, the philosopher, the teacher, each freely applying his chosen field of learning and exercising his inventive faculties and trained imagination in his own way, not as a subordinate in an administrative hierarchy, not as a hired seeker for what he is told to find by his superiors, but as a free seeker for the truth for its own sake, impelled by the spirit of public service inculcated in his profession.

Let us consider next the effect of the service state upon business and industry. A writer on administrative law tells us that administrative agencies set up by legislation were intended, and as he seems to think, justly intended, to be unfair. They were intended to render service to a group or element of the voting public assumed to be identifiable with the public. Whether this is so, it is at any rate clear enough from American as well as from English experience that the zeal of administrative agencies to achieve the immediate end they see before them leads them to see their function out of focus and to assume that constitutional limitations and guaranteed individual rights must give way before their zealous efforts to achieve what they see as a paramount purpose of government. The writer on administrative law referred to tells us that "political development represents a picture of increasing reliance by our society upon the administrative process." Hence, he argues, we must look on arbitrary and unfair bureau action "against a background of what we now expect government to do." It is not, however, wholly a question of what we expect government to do, but also one of how we expect government to do it. We must look at the methods of administrative agencies also in the light of their tendency to see the particular, relatively narrow task of each particular agency out of proportion.

This tendency, to take an example which is no longer controversial, was manifest under the regime of national prohibition. Those who were in charge of enforcement of the National Prohibition Act felt strongly, and no doubt conscientiously, that the objects of that act were of such paramount importance as to justify extra-legal measures and overriding of individual rights and constitutional guarantees. They looked only to what they considered we expected the government to do. Zeal in carrying out policies of service which are felt by bureaus which implement and administer them to be of paramount importance, justifying the means by the end, is demonstrating that our American constitutional policy is by no means something outgrown. The fundamental features of government which our constitutions were set up to deal with are as much in need of restraint today as they ever were. All exercise of power by politically organized society calls for checks.

That checks are particularly needed with respect to administrative regulation of business and industry is made clear by consideration of certain tendencies which may be seen in administrative agencies, federal and state, in America, and no less in such agencies in Great Britain and in the British dominions generally.

Most serious among these tendencies is one going counter to what has always been the first principle of judicial justice, namely, to hear the other side. In all administrative adjudication, there is an obstinate tendency to decide without a hearing, or without hearing one of the parties, or after conference with one of the parties in the absence of the other whose interests are injuriously affected. Another is to make determinations on the basis of consultations had in private or of reports not divulged, giving the party affected no opportunity to refute or explain. A very serious tendency is to make hearings prescribed by law a mere form, reaching conclusions from one-sided investigations not made public and using the hearings merely to give color of fairness to pronouncement of the predetermined result. In doing this decisions are reached without evidence, or without evidence of probative force or even in spite of evidence. In the last published volume of decisions of the United States Court of Appeals there are repeated cases where the courts have pointed out that the administrative agency systematically gave full credence to all witnesses on one side and systematically refused to believe anything testified to by any witness on the other side. One court said that cases of this sort had become a common experience of the federal courts of review. In a service state, regulating every kind of calling and activity by committing control of them to bureaus which conduct propaganda against subjecting them to effective checks, the burden upon business and industry may go so far as to end by turning them from private functions to functions of an omnicompetent state.

The result is to put our constitutional system out of balance. It tends to put the executive in control of agencies with power of life and death over business and industry and in control of a vast political patronage of officials, petty officials, experts, investigators, and employees, which a strong personality at the head can use to maintain himself in power.

In the last century we considered as postulates, as presuppositions of life in civilized society, that everyone was entitled to assume that others would commit no intentional aggressions upon him and that no one would subject him to unreasonable risk of injury. One who committed injurious aggressions or caused injury by unreasonable subjection of others to risk was bound to repair the injury. But where

injury resulted without any one's fault we considered that each of us must bear the risk of such accidents which, after all, are inevitable in human existence. What is called the insurance doctrine, the theory that injuries which are the lot of human existence should be insured against by some form of general social sharing of the burden, is a humanitarian addition to the teachings of the past. But the service of providing such insurance seems to be growing by analogy to a postulate that every loss to any one is to be shifted to someone else who is better able to bear it. Thus we get a new risk of life in civilized society, added to those imposed by the nature of things, namely, a risk of having to be involuntary Good Samaritans when any of our fellowmen suffer loss in case we are convenient to reach as such at the time. There is nothing conducive to thrift or to productive exertion in such a social program. It suggests what Epicurus proposed in the era of absolute military monarchies after the death of Alexander the Great. Epicurus said the wise man would keep as inconspicuous as possible and thus escape the notice of the tyrant.

Another circumstance that needs to be considered enters into the putting in practice of the insurance theory as to injuries in the course of operation of public utilities. Many now propose that all injuries to all persons through the operation of public utilities be committed by the service state to a regime analogous to workmen's compensation to be administered by an appropriate bureau. The theory is that these utilities are in a position to absorb the cost of making good the loss to the luckless victims of loss by accidents without fault (or even through their own fault where no one else is at fault) because they can pass the loss on to the public in their charges for services. But in the bureau state of today this is becoming fallacious in practice. One bureau or commission fixes rates. Another has control of wages and hours. A jury or another administrative agency fixes responsibility and assesses the amount of loss. Also the federal government, state, and municipality, may be imposing taxes and license fees. Thus with each of these agencies acting independently the burden cannot be adjusted either by the utility or by any one agency. The result as things are is that the burden is shifted arbitrarily to the most conveniently reached victim. This sort of thing has begun to reach into every side of our law in the service state.

Also another side of employer's liability requires consideration from the standpoint of justice which it is not likely to receive under the reign of the idea of the involuntary Good Samaritan. As the law has been and is, an employer is liable to repair injuries due to what is done by his employee in the course of and within the scope of his

employment. The reason given for this is that as the employer chooses the employee and has power of discharging him, if he employs a person and keeps that person in his employment he is at fault in choosing and employing one who proves capable of wrong-doing and should be liable for injuries resulting from that fault. Today, under a regime of collective bargaining, administrative constraint to retain or reinstate employees, vested rights of employees in their jobs, closed shops, limitation of the power to choose and abrogation of the power to discharge employees, the reason fails. But the liability of the employer for injury to third persons by the fault of the employee remains and is likely to remain under the doctrine that someone must answer for all loss to anyone, no matter how caused, and employers are the involuntary Good Samaritans most convenient to reach.

In cases against railroad companies in which there was much occasion for sympathy and but little basis for finding the company at fault, Lord Bramwell used to tell the jury a story of the pickpocket at the charity sermon who was so moved by the preacher's eloquence that he picked the pockets of everyone in the pew and put the contents in the plate. Much in the practical application of the humanitarian principle of the service state suggests the charitable activity of the pickpocket. One cannot quarrel with the high humanitarian purposes. But multiplication of charitable services, entailing great expense to be met by taxation and imposition of increasing heavy liabilities for what an enterprise cannot control or avoid, put a heavy burden upon enterprise and productive activity. It will be much easier to break down the economic order in that way than to rebuild when the mischief has been done.

Nor should we omit to consider the effect of extreme extensions of services rendered by the state on the morale of the people. On the one hand, administrative attempts to impose moral policies of bureaus upon business and industry, and, on the other hand, attempts to relieve pressure groups of liabilities which are imposed upon the rest of us confuse the whole relation of law and morals. One notable relaxation of morale is the breakdown of the feeling of duty to perform promises. A manifestation of this in high places may be seen in what is called the prediction theory of obligation. Consider what a promissory note would look like on this theory: Ninety days after date, for value received, I predict that I shall be willing and able to pay John Doe or order five hundred dollars. But this is not confined to juristic theory. Legislation impairing or doing away with the practical legal means of enforcing promises is upheld in a doctrine that a power of the legislature to relieve promisors of liability is implied in the sovereignty of

the state. Such relief is one of the services it may render. After experience of revocation of franchises at every turn of political fortune in seventeenth-century England and of colonial legislation interfering with enforcement of contracts and revoking charters, we put in our federal constitution a prohibition of state legislation impairing the obligation of contracts. This has in large part at least become a mere preaching, and the spirit that has substituted that preachment for an enforceable constitutional provision has been affecting regard for the upholding of promises on every side. There is no longer a feeling of moral duty to perform, and impairment of the legal duty as well undermines a main pillar of the economic order. The long-time end result of undermining the security of business transactions may yet show that the service done to a large body of voting debtors by the service state in going to the extreme in relieving them may not prove a service to the public.

That the quest of certainty and uniformity and stability in nineteenth-century law carried what might be called a hard-boiled attitude too far is clear enough. We ought, however, to have learned from the history of law that that hard-boiled attitude was a reaction from extreme individualized justice in a prior stage of legal development, and should have been able to avoid an extreme of counter-reaction in our zeal to be more humane today.

Again, old age pensions are certainly a great improvement over the parish relief Dickens describes and the poor house and poor farm and poor relief we used to provide. But in some states extension of this service is carried to the verge of putting a premium upon inactivity and a burden upon productive activity. It looks as if voters over the age of sixty voted themselves liberal aid beyond reach of creditors, with no obligation of doing anything for themselves and while holding property to transmit to their heirs. One state at least by its constitution assures everyone over sixty a pleasant, parasitic life. Older requirements making relief payments a lien on the property of the recipient are abrogated, all such securities given in the past are released and cancelled, and old age pensions are given priority over all other claims upon public revenues. When the state sets out to secure individual conditions of life the question arises at once what life is it that shall be secured? Is it a minimum life by the standards of the time and place, or a reasonable life by those standards, or an equal life, and if an equal life, equal to the community average or to the highest community level? If government is to undertake to satisfy all the desires and demands of everybody and bring about universal contentment, something more than human energy and productive exertion must be found

to provide the goods of existence out of which the desires and demands are to be satisfied.

In the same direction we may note extensions of bankruptcy relief so as to make escape from debts as easy as incurring them if not easier. For a generation legislation has increasingly limited the power of creditors to collect and created more and larger exemptions. I will not say that the service state is the cause of such things, but the state of mind that is behind extreme manifestations of the service idea must be held accountable. Nothing in the phenomena we have to investigate in the social sciences has a single cause. But current stress upon the high humanitarian designs of the service state and praise of its moral quality as compared with the supposed brutality of the legal order of the last century need to be weighed with the practical disappearance of the strict individual adherence to contracts and performance of promises which was believed in in the formative era of our institutions. What is needed here, as everywhere else, is balance. If letting people of full age and sound mind contract freely and holding them rigidly to the contracts they freely made was carried to an extreme in the last century, a system of restricting individual free contract and relaxing the obligation of contract may be carried quite as much too far in reaction. The man of high moral sense who after bankruptcy worked hard and in time voluntarily paid off his barred debts, used to be pointed out as an example of the just and upright man to whom his neighbors looked up. Today, I suppose, he would be set down a fool.

Now that the state builds great housing units with all conveniences, will not the next generation say, why require payment of rent? Why not furnish free comfortable housing up to at least the middle standard of the community for all who can't provide for themselves and at the same time enjoy the advantages of leisure and entertainment and good living of the middle standard? If men need not pay debts why should they pay rent? Does not the ideal of absolute equality of economic condition and advantages of life call for this? So men may next be arguing. The service state may easily shade into communism.

There are those who seem to teach people to expect government to furnish them employment for which they are not qualified. Would-be artists, would-be musicians, would-be writers, and would-be actors, are to be employed with public money to execute and exhibit what no one wants to buy, to perform or compose what no one wants to hear, to write what no one wants to read, or to act what no one wants to see. Thus no one's ambitions will be frustrated. A secure place in the calling one aspires to pursue is to be made for him by the state. We

saw something of this in the era of WPA. It is the logical carrying out of the doctrine that medical treatment and legal advice and advocacy are to be so brought to every one's back door that no one shall have better medical treatment or better advocacy or forensic talent at his disposal than any one else. Even then, however, all frustration will not be eliminated. How about those whose energy and productive exertions will be required for the material basis of this Utopia if only to pay the taxes?

But, as I said at the outset, the trouble is not with the idea of a service state in itself. The mere maintenance of order and keeping the peace is a service. What is required in government as in everything else is balance. He that believeth, says Isaiah, shall not make haste. Ultimate perfection of mankind can no more be achieved through government than through the other universal agencies of improving mankind men have believed in in the past. Additional services through the state where they can be performed by the state without waste of what we are doing and have learned how to do by other institutions and without reducing the individual to passive obedience or to parasitism is a reasonable program which need not carry us to the omnicompetent state.

PART TEN

The Role of Government in Economics

READING 128 is an illustration of religious rather than governmental control, but the effect of religious control has many parallels with that of governmental control. The effectiveness of such a sermon must have been marked, if we recall that each guild group sat as a unit; one can almost picture the clergyman pointing his finger at one group after another. Number 129 is an example of how a community tried to enforce some quality standards, in a rather picturesque way. Adam Smith is quoted on the subject of government regulation (130). The selection from John Stuart Mill (131) considers one phase of control: control over usury. Number 132 contains Ludwig von Mises's observations on the decline of ancient states. Number 133, by William H. Spencer, is an excellent account of the meaning of the contract, upon which much of our economic system rests. The statement made by President Roosevelt (134) when he signed the N.I.R.A., followed by the Supreme Court decision declaring the law unconstitutional (135), throws a great deal of light on the aims of the New Deal and the uncertainty as to how the Court would act on a measure of such far-reaching economic significance. Ruth Finney's article on interstate trade barriers (136) also helps to show the gropings of the state governments during the Great Depression. The Sherman Anti-Trust Act is quoted as Selection 137. It is followed by a synopsis of some forty pieces of legislation covering the same field (138). John May offers a list of some of the methods of unfair competition uncovered by the Federal Trade Commission in Selection 139. A very significant factor

in American life, the lobby, is the subject of Article 140. We have gone far from the day when legislation was conducted in person at town meetings. Elected representatives took our places, but now the lobby has become more articulate than we are—almost insulating us from our lawmakers. In Number 141, we are reminded of an old maxim of taxation going back to 1500–1200 B.C. In Number 142, the question of "excess" profits is considered. An early example of inheritance tax is shown in Number 143, with the familiar note that it was not popular then, either. In Number 144, the size of a billion dollars is suggested. Number 145 consists of F. C. Foy's question, "Is Money Unlimited?" by which he means money for government expenditures and taxation. In a lighter vein, Fred Othman discusses some of the wastes of surplus war material (146). The Budget for 1952 is analyzed in 147, and our national debt is considered in Number 148.

Other selections which might be read in connection with this Part are 13, 14, 16, 22, 27, 38, 71, 113, 115, 116, 120, and 127.

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(133) Spencer, W. H., *A Textbook of Law and Business,* McGraw-Hill, 1938, pp. 185–189.

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(138) *A History of Congressional Action in the Antitrust Field During the Past Fifty Years,* 81st Cong., 2d Session, House Document 599, Government Printing Office, 1950, pp. 3–12.

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(140) *General Interim Report of the House Select Committee on Lobbying Activities,* House of Representatives, 81st Cong., 2d Session, Government Printing Office, 1950, pp. 13, 5–10, 23, 62–67.

(141) Plehn, Carl C., *Introduction to Public Finance,* Macmillan, 1920, p. 4.

(142) *Government Finance,* Monthly Letter on Economic Conditions, National City Bank of New York, October 1950.

(143) *Select Cases in Chancery,* London: Selden Society, p. 23.

(144) "What is a Billion Dollars?" Advertisement in the *Pittsburgh Press,* November 2, 1940.

(145) Foy, F. C., "Is Money Unlimited?" Address delivered before the Institute of Business and Economic Problems, University of Pittsburgh, 1951.

(146) Othman, Fred, "War Assets," *Pittsburgh Press,* February 15, 1949.

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A THIRTEENTH-CENTURY SERMON

BERTHOLD VON REGENSBURG

THE FIRST ARE YE that work in clothing, silks, or wool or fur, shoes or gloves or girdles. Men can in nowise dispense with you; men must needs have clothing; therefore should ye so serve them as to do your work truly; not to steal half the cloth, or to use other guile, mixing hair with your wool or stretching it out longer, whereby a man thinketh to have gotten good cloth, yet thou hath stretched it to be longer than it should be, and maketh a good cloth into worthless stuff. Nowadays no man can find a good hat for thy falsehood; the rain will pour down through the brim into his bosom. Even such deceit is there in shoes, in furs, in curriers' work; one man sells an old skin for a new, and how manifold are thy deceits no man knoweth so well as thou and thy master the devil.

The second folk are such as work with iron goods. They should all be true and trustworthy in their office, whether they work by the day or by the piece. When they labor by the day, they should not stand all the more idle that they may multiply the days at their work. If thou laborest by the piece, then thou shouldest not hasten too soon therefrom, that thou mayest be rid of the work as quickly as possible, and that the house may fall down in a year or two. Thou shouldest work at it truly, even as it were thy own. Thou smith, thou wilt shoe a steed with a shoe that is naught; and the beast will go perchance a mile thereon when it is already broken, and the horse may go lame, or a man be taken prisoner, or lose his life. Thou art a devil and an apostate.

The third are such as are busied with trade; we cannot do without them. They bring from one kingdom to another what is good cheap there, and whatever is good cheap beyond the sea they bring to this

town, and whatever is good cheap here they carry over the sea. Thou trader, shouldst trust God that He will find thee a livelihood with true winnings. Yet now thou swearest so loudly how good thy wares are, and what profit thou givest the buyer thereby; more than ten or thirty times takest thou the names of the saints in vain—God and all His saints, for wares scarce worth five shillings! That which is worth five shillings thou sellest, maybe, sixpence higher than if thou hadst not been a blasphemer of our Lord, for thou swearest loud and boldly: "I have been already offered far more for these wares": and that is a lie. And if thou wilt buy anything from simple folk, thou turnest all thy mind to see how thou mayest get it from them without money, and weavest many lies before his face; and thou biddest thy partner go to the fair also, and goest then a while away and sayest to thy partner what thou wilt give the man for his wares, and biddest him come and offer less. Then the simple country fellow is affrightened, and will gladly see thee come back. "Of a truth," thou sayest, "by all the saints, no man will give thee so much for this as I!" Yet another would have given more.

The fourth are such as sell meat and drink, which no man can disregard. Wherefore it is all the more needful that they shouldst be true and honest therein; for other deceit dealeth only with earthly goods, but this deceit with a man's body. If thou offerest measly or rotten flesh that thou hast kept so long until it be corrupt, then art thou guilty perchance of one man's life, perchance of ten. Or if thou offerest flesh that was unwholesome before the slaughter, or unripe of age, which thou knowest well and yet givest it for sale, so that folk eat it into their clean souls which are so dear a treasure to Almighty God, then dost thou corrupt the noble treasure which God hast buried in every man; thou art guilty of the blood of these folk. The same say I of him who selleth fish. So are certain innkeepers and cooks in the town, who keep their sodden flesh too long, whereof a guest eateth and falleth sick thereafter for his life long. So also do certain others betray folk with corrupt wine or with moldy beer, unsodden mead, or give false measure, or mix water with the wine. Certain others, again bake rotten corn to bread, whereby a man may lightly eat his own death; and they salt their bread which is most unwholesome.

The fifth folk are such as till the earth for wine or corn. They should live truly toward their lords and toward their fellows, and among each other; not plough one over the other's landmark, nor trespass nor reap beyond the mark, not feed their cattle to another's harm, nor betray their fellows to the lord. Ye lords, ye deal sometimes

so ill with your poor folk, and can never tax them too high; ye would fain ever tax them higher and higher. Thou boor, thou bringest to the town a load of wood that is all full of crooked billets beneath; so sellest thou air for wood! And the hay thou layest so cunningly on the wagon that no man can profit thereby; thou art a right false deceiver.

The sixth folk are all that deal with medicine, and these must take great heed against untruth. He who is no good master of that art, let him in no wise undertake it, or folks' blood will be upon his head. Take heed, thou doctor, and keep thyself from this as thou lovest the kingdom of heaven. We have murderers enough without thee to slay honest folk.

So are some men deceivers and liars like the craftsmen. The shoemaker sayeth, "See, there are two most excellent soles," and he hath burned them before the fire. And the baker floods his dough with yeast, so that thou hath bought mere air for bread. And the huxter pours sometimes beer or water into his oil; and the butcher will sell calves' flesh at times, saying: "It is three weeks old," and it is scarce a week old.

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PUNISHMENTS OF AN EARLIER DAY

John Russell *who lived at Bilingsgate* "exposed 37 pigeons for sale, putrid, rotten, stinking, and abominable to the human race, to the scandal, contempt and disgrace of all the city, and the said John Russell says that the same pigeons are good and proper for sale to mankind, and he offers to prove the same, and hereupon, 2 pie-bakers, being sworn to inspect and examine whether the said pigeons are good and proper or not, say upon their oath that the said pigeons are

not good or wholesome for mankind, but rather to the corruption of man. Therefore he is to have judgment of the pillory, and the said pigeons are to be burned beneath the pillory, and the cause of his punishment is to be there proclaimed."

A SELLER OF *corrupt* WINE IN LONDON "the said John Penrose shall drink a draught of the same wine which he sold to the common people; and the remainder of such wine shall be poured on the head of the same John: and that he shall forswear the calling of a vintner in the City of London forever, unless he can obtain the favor of our Lord the King as to the same."

130·

GOVERNMENT REGULATION

ADAM SMITH

NO REGULATION OF COMMERCE can increase the quantity of industry in any society beyond what its capital can maintain. It can only divert a part of it into a direction into which it might not otherwise have gone; and it is by no means certain that this artificial direction is likely to be more advantageous to the society than that into which it would have gone of its own accord.

Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is to his own advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society.

* * * *

As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. . . .

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USURY LAWS

JOHN STUART MILL

LEGISLATORS MAY ENACT and maintain Usury Laws from one of two motives: ideas of public policy, or concern for the interest of the parties in the contract; in this case, of one party only, the borrower. As a matter of policy the notion may possibly be, that it is for the general good that interest should be low. It is, however, a misapprehension of the causes which influence commercial transactions, to suppose that the rate of interest is really made lower by law than it would be made by the spontaneous play of supply and demand. If the competition of bor-

rowers, left unrestrained, would raise the rate of interest of six per cent, this proves at five there would be a greater demand for loans than there is capital in the market to supply. If the law in these circumstances permits no interest beyond five per cent, there will be some lenders, who not choosing to disobey the law, and not being in a condition to employ their capital otherwise, will content themselves with the legal rate; but others, finding that in a season of pressing demand more may be made of their capital by other means than they are permitted to make by lending it, will not lend it at all; and the loanable capital, already too small for the demand, will be still further diminished. Of the disappointed candidates there will be many at such periods who must have their necessities supplied at any price, and these will readily find a third section of lenders, who will not be averse to join in a violation of the law, either by circuitous transactions partaking of the nature of fraud or by relying on the honour of the borrower. The extra expense of the roundabout mode of proceeding, and an equivalent for the risk of non-payment and of legal penalties, must be paid by the borrower, over and over above the extra interest which would have been required of him by the general state of the market. The laws which were intended to lower the price paid by him for pecuniary accommodation end thus in greatly increasing it. These laws have also a directly demoralizing tendency. Knowing the difficulty of detecting an illegal pecuniary transaction between two persons, in which no third person is involved, so long as it is the interest of both to keep the secret, legislators have adopted the expedient of tempting the borrower to become the informer, by making the annulment of the debt a part of the penalty for the offence; thus rewarding men for first obtaining the property of others by false promises, and then not only refusing payment, but invoking legal penalties on those who have helped them in their need. The moral sense of mankind very rightly infamizes those who resist an otherwise just claim on the ground of usury, and tolerates such a plea only when resorted to as the best legal defence available against an attempt really considered as partaking of fraud or extortion. But this very severity of public opinion renders the enforcement of the laws so difficult, and the infliction of the penalties so rare, that when it does occur it merely victimizes an individual, and has no effects on general practice.

In so far as the motive of the restriction may be supposed to be, not public policy, but regard for the interest of the borrower, it would be difficult to point out any case in which such tenderness on the legislator's part is more misplaced. A person of sane mind, and of the age

at which persons are legally competent to conduct their own concerns, must be presumed to be a sufficient guardian of his pecuniary interests. If he may sell an estate, or grant a release, or assign away all his property, without control from the law, it seems very unnecessary that the only bargain which he cannot make without its intermeddling, should be a loan of money. The law seems to presume that the money-lender, dealing with necessitous persons, can take advantage of their necessities, and exact conditions limited only by his own pleasure. It might be so if there were only one money-lender within reach. But when there is the whole monied capital of a wealthy community to resort to, no borrower is placed under any disadvantage in the market merely by the urgency of his need. If he cannot borrow at the interest paid by other people, it must be because he cannot give such good security: and competition will limit the extra demand to a fair equivalent for the risk of his proving insolvent. Though the law intends favour to the borrower, it is to him above all that injustice is, in this case, done by it. What can be more unjust than that a person who cannot give perfectly good security should be prevented from borrowing of persons who are willing to lend money to him, by their not being permitted to receive the rate of interest which would be a just equivalent for their risk? Through the mistaken kindness of the law, he must either go without the money which is perhaps necessary to save him from much greater losses, or be driven to expedients of a far more ruinous description, which the law either has not found it possible, or has not happened, to interdict.

Adam Smith rather hastily expressed the opinion, that only two kinds of persons, "prodigals and projectors," could require to borrow money at more than the market rate of interest. He should have included all persons who are in any pecuniary difficulties, however temporary their necessities may be. It may happen to any person in business, to be disappointed of the resources on which he had calculated for meeting some engagement, the non-fulfillment of which on a fixed day would be bankruptcy. In periods of commercial difficulty, this is the condition of many prosperous mercantile firms, who become competitors for the small amount of disposable capital which, in a time of general distrust, the owners are willing to part with. Under the English usury laws, now happily abolished, the limitations imposed by those laws were felt as a most serious aggravation of every commercial crisis. Merchants who could have obtained the aid they required at an interest of seven or eight per cent for short periods, were obliged to give 20 or 30 per cent or to resort to forced sales of

goods at a still greater loss. Experience having obtruded these evils on the notice of Parliament, the sort of compromise took place of which English legislation affords so many instances, and which helps to make our laws and policy the mass of inconsistency that they are. The law was reformed as a person reforms a tight shoe, who cuts a hole in it where it pinches hardest, and continues to wear it. Retaining the erroneous principle as a general rule, Parliament allowed an exception in the case in which the practical mischief was most flagrant. It left the usury laws unrepealed, but exempted bills of exchange, of not more than three months' date, from their operation. Some years afterwards the laws were repealed in regard to all other contracts, but left in force as to all those which relate to land. Not a particle of reason could be given for making this extraordinary distinction: but the "agricultural mind" was of opinion that the interest on mortgages, although it hardly ever came up to the permitted point, would come up to a still higher point; and the usury laws were maintained that landlords might, as they thought, be enabled to borrow below the market rate, as the corn-laws were kept up that the same class might be able to sell corn above the market rate. The modesty of the pretension was quite worthy of the intelligence which could think that the end aimed at was in any way forwarded by the means used.

With regard to the "prodigals and projectors" spoken of by Adam Smith; no law can prevent a prodigal from ruining himself, unless it lays him or his property under actual restraint, according to the unjustifiable practice of the Roman Law and some of the Continental systems founded on it. The only effect of usury laws upon a prodigal is to make his ruin rather more expeditious, by driving him to a disreputable class of money-dealers, and rendering the conditions more onerous by the extra risk created by the law. As for projectors (a term, in its unfavourable sense, rather unfairly applied to every person who has a project), such laws may put a veto upon the prosecution of the most promising enterprise, when planned, as it generally is, by a person who does not possess capital adequate to its successful completion. Many of the greatest improvements were at first looked shyly on by capitalists, and had to wait long before they found one sufficiently adventurous to be the first in a new path: many years elapsed before Stephenson could convince even the enterprising mercantile public of Liverpool and Manchester of the advantage of substituting railways for turnpike roads; and plans on which great labour and large sums have been expended with little visible result, (the epoch in their progress when predictions of failure are most rife,) may be

indefinitely suspended, or altogether dropped, and the outlay all lost, if, when the original funds are exhausted, the law will not allow more to be raised on the terms on which people are willing to expose it to the chances of an enterprise not yet secure of success.

132 ·

OBSERVATIONS ON THE CAUSES OF THE DECLINE OF ANCIENT CIVILIZATION

LUDWIG VON MISES

Knowledge of the effects of government interference with market prices makes us comprehend the economic causes of a momentous historical event, the decline of ancient civilization.

It may be left undecided whether or not it is correct to call the economic organization of the Roman Empire capitalism. At any rate it is certain that the Roman Empire in the second century, the age of the Antonines, the "good" emperors, had reached a high stage of the social division of labour and of inter-regional commerce. Several metropolitan centres, a considerable number of middle-size towns, and many small towns were the seats of a refined civilization. The inhabitants of these urban agglomerations were supplied with food and raw materials not only from the neighbouring rural districts, but also from distant provinces. A part of these provisions flowed into the cities as revenue of their wealthy residents who owned landed property. But a considerable part was bought in exchange for the rural population's purchases of the products of the city-dwellers' processing activities. There was an extensive trade between the various regions of the vast empire. Not only in the processing industries, but also in agriculture there was a tendency toward further specialization. The various parts

of the empire were no longer economically self-sufficient. They were mutually interdependent.

What brought about the decline of the empire and the decay of its civilization was the disintegration of this economic inter-connectedness, not the barbarian invasions. The alien aggressors merely took advantage of an opportunity which the internal weakness of the empire offered to them. From a military point of view the tribes which invaded the empire in the fourth and fifth centuries were not more formidable than the armies which the legions had easily defeated in earlier times. But the empire changed. Its economic and social structure was already mediaeval.

The freedom that Rome granted to commerce and trade had always been restricted. The marketing of cereals and other vital necessities was even more restricted than with regard to other commodities. It was deemed unfair and immoral to ask for grain, oil and wine, the staples of these ages, more than the customary prices, and the municipal authorities were quick to check what they considered profiteering. Thus the evolution of an efficient wholesale trade in these commodities was prevented. The policy of the *annona,* which was tantamount to a nationalization or municipalization of the grain trade, aimed at filling the gaps. But its effects were rather unsatisfactory. Grain was scarce in the urban agglomerations, and the agriculturists complained about the unremunerativeness of grain growing. The interference of the authorities upset the adjustment of supply to the rising demand.

The show-down came when in the political troubles of the third and fourth centuries the emperors resorted to currency debasement. With the system of maximum prices the practice of debasement completely paralyzed both the production and the marketing of the vital foodstuffs and disintegrated society's economic organization. The more eagerness the authorities displayed in enforcing the maximum prices, the more desperate became the conditions of the urban masses dependent on the purchase of food. Commerce in grain and other necessities vanished altogether. To avoid starving, people deserted the cities, settled on the countryside, and tried to grow grain, oil, wine, and other necessities for themselves. On the other hand, the owners of the big estates restricted their excess production of cereals and began to produce in their farmhouses—the villae—the products of handicraft which they needed. For their big-scale farming, which was already seriously jeopardized because of the inefficiency of slave labour, lost its rationality completely when the opportunity to sell at remunerative prices disappeared. As the owner of the estate could no longer sell in the cities, he could no longer patronize the urban artisans either. He was

forced to look for a substitute to meet his needs by employing handicraftsmen on his own account in his villa. He discontinued big-scale farming and became a landlord receiving rents from tenants or sharecroppers. These coloni were either freed slaves or urban proletarians who settled in the villages and turned to tilling the soil. A tendency toward the establishment of autarky of each landlord's estate emerged. The economic function of the cities, of commerce, trade, and urban handicrafts, shrank. Italy and the provinces of the empire returned to a less advanced state of the social division of labour. The highly developed economic structure of ancient civilization retrograded to what is now known as the manorial organization of the Middle Ages.

The emperors were alarmed with that outcome, which undermined the financial and military power of their government. But their counteraction was futile as it did not affect the root of the evil. The compulsion and coercion to which they resorted could not reverse the trend toward social disintegration which, on the contrary, was caused precisely by too much compulsion and coersion. No Roman was aware of the fact that the process was induced by the government's interference with prices and by currency debasement. It was vain for the emperors to promulgate laws against the city-dweller who *relicta civitate rus habitare maluerit.* The system of the leiturgia, the public services to be rendered by the wealthy citizens, only accelerated the retrogression of the division of labour. The laws concerning the special obligation of the ship owners, the navicularii, were no more successful in checking the decline of navigation than the laws concerning grain dealing in checking the shrinkage in the cities' supply of agricultural products.

The marvelous civilization of antiquity perished because it did not adjust its moral code and its legal system to the requirements of the market economy. A social order is doomed if the actions which its normal functioning requires are rejected by the standards of morality, are declared illegal by the laws of the country, and are prosecuted as criminal by the courts and the police. The Roman Empire crumbled to dust because it lacked the spirit of liberalism and free enterprise. The policy of interventionism and its political corollary, the Fuehrer principle, decomposed the mighty empire as they will by necessity always disintegrate and destroy any social entity.

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THE LAW OF CONTRACTS

WILLIAM H. SPENCER

Freedom of Contract.—In an economic society which theoretically has been dominated by a philosophy of individualism, it has been assumed that there should be relatively complete freedom of persons to make contracts. Courts of the common law accordingly placed their approval upon all contracts between persons of normal capacity, except those which in their opinion are contrary to sound social policy and those which have been induced by fraud or duress. Courts in the establishment of the doctrine of freedom of contract proceeded upon the assumption that there is substantial bargaining equality between all persons of sound mind and legal age. However defensible this assumption may have been in an earlier regime, it became increasingly clear that in a modern complicated business regime the assumption was no longer tenable. Accordingly, socialistically inclined legislatures began to enact many different types of legislation, particularly in the field of labor relations, placing many restrictions upon the doctrine of freedom of contract.

Subject Matter of Contract.—"The law on contracts may be described as the endeavor of the state, a more or less imperfect one by the nature of the case, to establish a positive sanction for the expectation of good faith which has grown up in the mutual dealings of men of average right-mindedness. Accordingly, the most popular description of a contract that can be given is also the most exact one, namely, that it is a promise or set of promises which the law will enforce." It is clear, therefore, that a study of contracts is a study of promises.

A promise is a statement of intention, carrying assurance that the promisor will do or refrain from doing something in the future. It is a

proposal of conduct. A promise must be differentiated from a *representation,* which is a statement of a past or present fact. A promise is a statement of what one proposes to do or not to do in the future. A statement in an insurance policy that a watchman is kept on the premises at night is merely a representation of fact. A statement that a watchman will be kept on the premises is a promise.

A promise must also be distinguished from a *condition.* A condition is a statement of an uncertain event, present or future, upon the happening or non-happening of which something else depends. A promise carries with it an assurance that the event will or will not happen. A condition carries no such assurance. A statement in an insurance policy that the policy is void if the insured keeps gasoline on the insured premises is a condition. A statement by the insured that he will not keep gasoline on the premises is a promise.

Although promises are the subject matter of contract, the law does not enforce all promises. There are many promises to which the law does not attach enforcibility. Promises in terms of enforcibility may be classified as "socially harmful," "socially indifferent," and "socially useful." An antisocial promise is one the performance of which not only does not assist in carrying out the ends of society but which, according to prevailing social and economic ideals, actually injures society and retards its work. A promise to kill a person, to steal property, to defame a person, to obstruct the administration of justice, are illustrations of promises which are socially harmful. A socially indifferent promise is one the performance of which is neither particularly useful nor particularly harmful to society. A promise to make a gift falls in this category. It is a matter of indifference to society whether a promise to make a gift is performed or not. A socially useful promise is one which is serviceable in the affairs of society. It is a promise which is utilized in the buying and selling of conduct, services, and goods. Generally speaking, the law enforces only those promises which are socially useful: promises which assist society in working out its ends.

History of Enforcibility of Promises.—The enforcibility of simple promises is a fairly recent development of the common law. The doctrine did not receive full recognition until about the middle of the sixteenth century. That this important development should have come about so late in the history of the common law is not surprising, as the social and economic needs of England had not much earlier required the enforcibility of simple promises.

If we look at the situation in England at the close of the twelfth

century, we find the social organization essentially a military one. England was organized on a feudalistic basis, of which the manor was the unit. The people were permanently settled and almost indissolubly attached to their respective manorial organizations. They were engaged for the most part in agricultural pursuits except when called upon by the overlords to perform military service. The manors were self-sufficing. The whole organization was non-commercial in character. In this stage of society, transactions were simple and few in number. On the one hand, there were transactions dealing with formal relations, like marriage, apprenticeships, and conveyances of land, the making of which was formalistic. On the other hand, there were transactions like barter, pledging, and loaning of goods. The parties of these more or less naturally thought in terms of tangible objects and dealt in *praesenti* and not *in future.*

At this time, the remedies for obligations resembling modern contracts were few. In convenant the plaintiff could recover damages for the breach of a promise made under seal. In an action of account he could compel the defendant to account for money which he had received for the use of the plaintiff. In detinue he could recover possession of property which another wrongly detained. In the action of debt he could recover money in cases in which the defendant under seal had admitted the existence of a debt owing to the plaintiff; and also a "sum certain" in money if he could establish that he had given the debtor *quid pro quo,* such as goods, services, the use of land, or money, for the debt. From the foregoing statement it is clear that simple, executory promises, which constitute the bulk of present enforcible, contractual obligations, were outside the jurisdiction of courts.

Existing obligations met the needs of England at the close of the twelfth century. As early, however, as the thirteenth century forces were operating to break down the manorial organization in England. As it disappeared during the succeeding centuries, towns and trading centers sprang up. Agriculture ceased to be the principal occupation of the people. Sheep-raising and the woolen industry appeared. Organizations of workers in specialized lines were formed. Local self-sufficiency no longer characterized the internal organizations of England. Trading—locally, between towns, and even more remotely—increased rapidly. Transactions of a kind seldom known or required in the strict manorial economy appeared. The remedies of the courts relating to present exchange of tangible objects were not adequate for the new order. When producing for the future, men

necessarily had to plan for the future. Their plans had to include the future conduct of others, and could no longer be limited to dealings with present, tangible objects. They could not make such plans until simple promises, appropriately made, were legally binding.

Pressure for the enforcibility of simple promises became so insistent during the period in question that ecclesiastical courts began to assume jurisdiction over them. These courts theoretically had jurisdiction only in spiritual matters. Here, however, was an opportunity to secure lucrative business which the lay courts were reluctant to handle. It was not difficult for the churchman to find that a failure to perform a promise, when one had pledged his faith, was a sin punishable by censure and excommunication. Moreover, it was an easy matter for men so to frame their agreements that they could be enforced by the church courts. "Within these twenty years," said Justice Bereford in 1303, "people have been accustomed to take bonds binding debtors to submit to the decision of the Holy Church in mercantile matters, and by these obligations they used to draw to the Church pleas of debt; and it was seen that it was against the law, and it was ordained that they should no longer intermeddle with those kinds of pleas." "As late as 1460 all the judges in the Exchequer Chamber found it necessary to restate formally the rule that *laesio fidei,* breach of faith, could not be made the means to give these courts a general jurisdiction over contracts."

Prior to 1500, the growing demand for the enforcibility of simple promissory statements began to find an outlet in the courts of equity. These courts were new, full of vigor, and more ready to mold their remedies to suit the needs of the new order than were the common-law courts. Suitors began to go before the chancellor and ask for relief or promises, unenforcible at law. "The attitude of the chancellor served as an admonition to the law judges that they must go in and occupy the field covered by the simple promise, otherwise the court of equity would take jurisdiction upon itself. The uneasiness felt by the law judges was voiced by Fairfax, J., in 1481, who insisted that the action on the case should be extended so as to obviate the necessity of suitors going into chancery."

The king's courts were jealous of these tribunals to which appeals were being made for the enforcement of simple promises. They wanted the fees which accompanied an increase in litigation. They accordingly yielded to the pressure of the times and gradually, although more or less unconsciously, devised remedies for the breach of simple promises, through the extension of existing writs under the authority of the Statute of Westminister III. By the middle of the

sixteenth century it was generally understood that simple promises were enforcible, and that the appropriate remedy for their enforcement was the action of trespass on the case on promises, which later came popularly to be known as the action of *assumpsit.*

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STATEMENT OF PRESIDENT ROOSEVELT ON THE NATIONAL INDUSTRIAL RECOVERY ACT, JUNE 16, 1933

THE LAW I have just signed was passed *to put people back to work*—to let them buy more of the products of farms and factories and start our business at a living rate again. This task is in two stages—first, to get many hundreds of thousands of the unemployed back on the pay roll by snowfall and second, to plan for a better future for the longer pull. While we shall not neglect the second, the first stage is an emergency job. It has the right of way.

* * * *

On this idea, the first part of the act proposes to our industry a great spontaneous cooperation to put millions of men back in their regular jobs this summer. The idea is simply for employers to hire more men to do the existing work by reducing the work-hours of each man's week and at the same time paying a living wage for the shorter week.

No employer and no group of less than all employers in a single trade could do this alone and continue to live in business competition. But if *all* employers in each trade now band themselves faithfully in these modern guilds—without exception—and agree to act together and at once, none will be hurt and millions of workers, so long de-

prived of the right to earn their bread in the sweat of their labor, can raise their heads again. The challenge of this law is whether we can sink selfish interest and present a solid front against a common peril.

It is a challenge to industry which has long insisted that, given the right to act in unison, it could do much for the general good which has hitherto been unlawful. From today it has that right.

* * * *

This law is also a challenge to labor. Workers, too, are here given a new charter of rights long sought and hitherto denied. But they know that the first move expected by the Nation is a greater cooperation of all employers, by one single mass action, to improve the case of workers on a scale never attempted in any nation. Industries can do this only if they have the support of the whole public and especially of their own workers. This is not a law to foment discord and it will not be executed as such. This is a time for mutual confidence and help and we can safely rely on the sense of fair play among all Americans to assure every industry which now moves forward promptly in this united drive against depression that its workers will be with it to a man.

It is, further, a challenge to administration. We are relaxing some of the safeguards of the antitrust laws. The public must be protected against the abuses that led to their enactment, and to this end we are putting in place of old principles of unchecked competition some new Government controls. They must above all be impartial and just. Their purpose is to free business—not to shackle it—and no man who stands on the constructive forward-looking side of his industry has anything to fear from them. To such men the opportunities for individual initiative will open more amply than ever. Let me make it clear, however, that the antitrust laws still stand firmly against monopolies that restrain trade and price fixing which allows inordinate profits or unfairly high prices.

* * * *

Finally, this law is a challenge to our whole people. There is no power in America that can force against the public will such action as we require. But there is no group in America that can withstand the force of an aroused public opinion. This great cooperation can succeed only if those who bravely go forward to restore jobs have

aggressive public support and those who lag are made to feel the full weight of public disapproval.

* * * *

Between these twin efforts—public works and industrial reemployment, it is not too much to expect that a great many men and women can be taken from the ranks of the unemployed before winter comes. It is the most important attempt of this kind in history. As in the great crisis of the World War, it puts a whole people to the simple but vital test: *"Must we go on in many groping, disorganized, separate units to defeat or shall we move as one great team to victory?"*

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THE SUPREME COURT AND THE N.I.R.A.

Mr. Chief Justice Hughes delivered the opinion of the court.

Petitioners in No. 854 were convicted in the District Court of the United States for the Eastern District of New York on eighteen counts of an indictment charging violations of what is known as the "Live Poultry Code" (1), and on an additional count for conspiracy to commit such violations (2). By demurrer to the indictment and appropriate motions on the trial the defendants contended (1) that the code had been adopted pursuant to an unconstitutional delegation by Congress of legislative power; (2) that it attempted to regulate intrastate transactions which lay outside the authority of Congress; and (3) that in certain provisions it was repugnant to the due process clause of the amendment.

The Circuit Court of Appeals sustained the conviction on the con-

spiracy count and on sixteen counts for violation of the code but reversed the conviction on two counts which charged violation of requirements as to minimum wages and maximum hours of labor, as these were not deemed to be within the Congressional power of regulation.

* * * *

The "Live Poultry Code" was promulgated under Section 3 of the National Industrial Recovery Act. That section . . . authorizes the President to approve "codes of fair competition."

Such a code may be approved for a trade or industry, upon application by one or more trade or industrial associations or groups, if the President finds (1) that such associations or groups "impose no inequitable restrictions on admission to membership therein and are truly representative," and (2) that such codes are not designed "to promote monopolies or to eliminate or oppress small enterprises and will not operate to discriminate against them, and will tend to effectuate the policy" of Title I of the act.

Such codes "shall not permit monopolies or monopolistic practices." As a condition of his approval, the President may "impose such conditions (including requirements for the making of reports and the keeping of accounts) for the protection of consumers, competitors, employes and others, and in furtherance of the public interest, and may provide such exceptions to and exemptions from the provisions of such code as the President in his discretion deems necessary to effectuate the policy herein declared."

* * * *

The "Live Poultry Code" was approved by the President on April 13, 1934. Its divisions indicate its nature and scope. The code has eight articles entitled (1) purposes, (2) definitions, (3) hours, (4) wages, (5) general labor provisions, (6) administration, (7) trade practice provisions, and (8) general.

* * * *

The charges in the ten counts, respectively, were that the defendants in selling to retail dealers and butchers had permitted "selections of individual chickens taken from particular coops and half coops."

Of the other six counts, one charged the sale to a butcher of an unfit chicken; two counts charged the making of sales without having the poultry inspected or approved in accordance with regulations or ordinances of the City of New York; two counts charged the making of false reports or the failure to make reports relating to the range of daily prices and volume of sales for certain periods; and the remaining count was for sales to slaughterers or dealers who were

without licenses required by the ordinances and regulations of the City of New York.

* * * *

First—two preliminary points are stressed by the government with respect to the appropriate approach to the important questions presented. We are told that the provision of the statute authorizing the adoption of codes must be viewed in the light of the grave national crisis with which Congress was confronted. Undoubtedly, the conditions to which power is addressed are always to be considered when the exercise of power is challenged. Extraordinary conditions may call for extraordinary remedies. But the argument necessarily stops short of an attempt to justify action which lies outside the sphere of constitutional authority. Extraordinary conditions do not create or enlarge constitutional power.

The Constitution established a national government with powers deemed to be adequate, as they have proved to be both in war and peace, but these powers of the national government are limited by the constitutional grants. Those who act under these grants are not at liberty to transcend the imposed limits because they believe that more or different power is necessary. Such assertions of extra-constitutional authority were anticipated and precluded by the explicit terms of the Tenth Amendment, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

The further point is urged that the national crisis demanded a broad and intensive cooperative effort by those engaged in trade and industry, and that this necessary cooperation was sought to be fostered by permitting them to initiate the adoption of codes.

But the statutory plan is not simply one for voluntary effort. It does not seek merely to endow voluntary trade or industrial associations or groups with privileges or immunities. It involves the coercive exercise of the law-making power.

The codes of fair competition which the statute attempts to authorize are codes of laws. If valid, they place all persons within their reach under the obligation of positive law, binding equally those who assent and those who do not assent. Violations of the provisions of the codes are punishable as crimes.

* * * *

The question of the delegation of legislative power. We recently had occasion to review the pertinent decisions and the general principles which govern the determination of this question. The Congress is not permitted to abdicate or to transfer to others the essential legisla-

tive functions with which it is thus vested. Accordingly, we look to the statute to see whether Congress has over-stepped these limitations, whether Congress in authorizing "Codes of Fair Competition" has itself established the standards of legal obligation, thus performing its essential legislative function, or, by the failure to enact such standards, has attempted to transfer that function to others.

* * * *

But would it be seriously contended that Congress could delegate its legislative authority to trade or industrial associations or groups so as to empower them to enact the laws they deem to be wise and beneficent for the rehabilitation and expansion of their trade or industries?

* * * *

And could an effort of that sort be made valid by such a preface of generalities as to permissible aims as we find in Section 1 of Title I? The answer is obvious. Such a delegation of legislative power is unknown to our law and is utterly inconsistent with the constitutional prerogatives and duties of Congress.

* * * *

We think that the code-making authority thus conferred is an unconstitutional delegation of legislative power.

* * * *

The question of the application of the provisions of the Live Poultry Code to intrastate transactions. Although the validity of the codes (apart from the question of delegation) rests upon the commerce clause of the Constitution, Section 3a is not in terms limited to interstate and foreign commerce. From the generality of terms, and from the argument of the government at the bar, it would appear that Section 3a was designed to authorize codes without that limitation.

* * * *

The poultry had come to a permanent rest within the State. It was not held, used or sold by defendants in relation to any further transaction in interstate commerce and was not destined for transportation to other States. Hence, decisions which deal with a stream of interstate commerce—where goods come to rest within a State temporarily and are later to go forward in interstate commerce—and with the regulations of transactions involved in that practical continuity of movement, are not applicable here.

* * * *

The question of chief importance relates to the provisions of the code as to the hours and wages of those employed in defendants'

slaughter-house markets. It is plain that these requirements are imposed in order to govern the details of defendants' management of their local business. The persons employed in slaughtering and selling in local trade are not employed in interstate commerce. Their hours and wages have no direct relation to interstate commerce.

* * * *

The apparent implication is that the Federal authority under the commerce clause should be deemed to extend to the establishment of rules to govern wages and hours in intrastate trade and industry generally throughout the country, thus overriding the authority of the States to deal with domestic problems arising from labor conditions in their internal commerce.

It is not the province of the court to consider the economic advantages or disadvantages of such a centralized system. It is sufficient to say that the Federal Constitution does not provide for it. Our growth and development have called for wide use of the commerce power of the Federal Government in its control over the expanded activities of interstate commerce and in protecting that commerce from burdens, interferences and conspiracies to restrain and monopolize it.

But the authority of the Federal Government may not be pushed to such an extreme as to destroy the distinction, which the commerce clause itself establishes, between commerce "among the several States" and the internal concerns of a State. The same answer must be made to the contention that is based upon the serious economic situation which led to the passage of the Recovery Act—the fall in prices, the decline in wages and employment and the curtailment of the market for commodities.

Stress is laid upon the great importance of maintaining wage distributions which would provide the necessary stimulus in starting "the cumulative forces making for expanding commercial activity." Without in any way disparaging this motive, it is enough to say that the recuperative efforts of the Federal Government must be made in a manner consistent with the authority granted by the Constitution.

We are of the opinion that the attempt through the provisions of the code to fix the hours and wages of employes of defendants in their intrastate business was not a valid exercise of Federal power.

The other violations for which defendants were convicted related to the making of local sales. Ten counts, for violation of the provision as to "straight killing," were for permitting customers to make

"selections of individual chickens taken from particular coops and half-coops."

Whether or not this practice is good or bad for the local trade, its effect, if any, upon interstate commerce was only indirect. The same may be said of violations of the code by intrastate transactions consisting of the sale "of an unfit chicken" and of sales which were not in accord with the ordinances of the City of New York. The requirement of reports as to prices and volumes of defendants' sales was incident to the effort to control their intrastate business.

In view of these conclusions, we find it unnecessary to discuss other questions which have been raised as to the validity of certain provisions of the code under the due process clause of the Fifth Amendment.

On both the grounds we have discussed, the attempted delegation of legislative power and the attempted regulation of intrastate transactions which affect interstate commerce only indirectly, we hold the code provisions here in question to be invalid and that the judgment of conviction must be reversed.

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INTERSTATE TRADE BARRIERS

RUTH FINNEY

NOBODY WANTS TO DRINK red milk. That's why Rhode Island poured red coloring matter into Vermont milk a year or so ago. It was protecting the home dairy industry.

Vermont protested, but someone found an old law, once on the Vermont statute books, requiring that oleomargarine coming into the state had to be colored pink.

Purple milk and green margarine figured in another interstate trade war.

The dairy industry was one of the first to demand protective legislation, and since in its upper brackets it is one of the richest and most powerful industries in the country, it has had conspicuous successes, so conspicuous that free trade in dairy products is practically unknown today.

The upper brackets were most interested in fighting margarine. The dairy farmers, restricted to low prices by the few big companies at the top, worried about milk shipped in from other states.

Every state now has legislation of some kind on its books about margarine, ranging from mild labeling requirements to drastic tax laws. Thirty states levy excise taxes or license fees or both.

Wisconsin charges 15 cents a pound on all margarine sold, given away, delivered or used in the state. Manufacturers pay a $1000-a-year fee, wholesalers $500. Hotels and restaurants that serve margarine pay $25 a year. There is even a $1 tax on users.

Oleomargarine is made of cottonseed oil, animal oil or coconut oil, and could be sold for much less than butter.

The South would like to see its cottonseed oil used this way, and most Southern states in retaliation have established legal or voluntary embargoes on Wisconsin beer, cheeses and other products.

The South also frowns on margarine made of animal oils. The Midwest frowns on margarine made of anything else. They retaliate against each other.

The technique for protecting milk from outside competition has been different.

Each state has milk inspection laws—proper and necessary for safe-guarding the health of its citizens. But these laws have been so worded or so administered in most states that they discriminate against products from outside.

For instance, the Connecticut Milk Commission does not examine dairies outside its own limited milkshed, and doesn't admit milk from dairies it hasn't inspected.

New York, Pennsylvania, New Jersey, Georgia, all make it practically impossible for milk to enter from beyond their own small milksheds.

Eighteen states have given boards the right to fix the price at which milk shall be bought from farmers. The farmers want a high price fixed. But as soon as it is, they scurry around to make it impossible for competing milk to enter from another milkshed.

As the whole thing works out, the price to the consumer remains

high, few dairy farmers make enough to prosper, and low-income families have to turn to powdered milk or do without.

It's almost as bad with eggs. Wyoming requires that every "foreign" egg—any egg, that is, from Colorado or Idaho—must be so branded. A number of states provide that no egg is "strictly" fresh if it has crossed a state line, no matter how close that line may be to the market.

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THE SHERMAN ANTI-TRUST ACT, JULY 2, 1890

AN ACT TO PROTECT trade and commerce against unlawful restraints and monopolies. . . .

Be it enacted

Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

* * * *

Sec. 4. The several circuit courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the courts shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decrees, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

Sec. 5. Whenever it shall appear to the court before which any proceeding under Section 4 of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshall thereof.

Sec. 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in Section 1 of this act, and being in the course of transportation from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

Sec. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

Sec. 8. That the word "person," or "persons," wherever used in this act, shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

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SYNOPSIS OF FEDERAL ANTI-TRUST LEGISLATION

FEDERAL TRADE COMMISSION ACT

(Public Law 203, 63d Cong., 38 Stat. 717, as amended by Wheeler-Lea Act, Mar. 21, 1938, 52 Stat. 111; U.S.C. 15:41–58)

CREATES a Federal Trade Commission. States that unfair methods of competition and unfair or deceptive acts or practices in commerce are unlawful. Empowers and directs the Commission to prevent persons, partnerships, or corporations, except banks and common carriers, from using unfair methods of competition, etc., by issuing, after hearing, an order to cease and desist enforceable by courts. The Commission is empowered to investigate business operations, etc., of corporations, etc., to investigate violations of the antitrust act for the President or Congress; to recommend business adjustments to comply with the law upon application of the Attorney General; to investigate compliance with antitrust decrees entered against violators; and to investigate conditions abroad affecting foreign trade. In equity antitrust suits brought by the Attorney General the court may refer the suit to the Commission, as master in chancery, to formulate an appropriate decree. The Commission may require the filing of detailed annual or special reports by corporations.

Makes dissemination of false advertisements unlawful. Violation of the cease and desist orders isued under the Federal Trade Commission Act, after such orders have become final, subjects the violator to civil penalties in suits instituted by the Attorney General.

CLAYTON ACT

(Public Law 212, 63d Cong., 38 Stat. 730, as amended by Robinson-Patman Act, June 19, 1936, 49 Stat. 1526; U. S. C. 15:12–27)

Prohibits (a) price discrimination (except when based on grade, quality, or quantity; or made in good faith to meet competition; or where only due allowance for difference in the cost of selling or transportation is made) where the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce. Bona fide selection of customers is allowed.

Prohibits (b) exclusive dealing leases, sales, contracts, discounts and rebates where the effect may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Prohibits (c) acquisition by one corporation of the stock of another (except for investment or development of carrier "feeder lines," etc.) where the effect may be to substantially lessen competition between the corporations or to restrain commerce in any section or community, or tend to create a monopoly of any line of commerce.

Prohibits (d) certain interlocking directorates.

Limits purchases by common carriers in case of interlocking directorates and prohibits interference with bidding.

Gives right to recover treble damages to persons injured by violation of antitrust laws. Makes decrees of antitrust violation prima facie evidence against defendants in other suits. Declares legality of labor, agricultural or horticultural organizations and provides that nothing in antitrust laws shall forbid individual members from lawfully carrying out legitimate objectives.

Confers right to private injunctive relief (except against common carriers) to those threatened by loss or damage as a result of violation of antitrust laws.

Limits issuance of restraining orders or injunctions in labor disputes.

Specifies injunction and contempt procedure.

An order to cease and desist under the act must be affirmed by a United States Circuit Court of Appeals on application for review by the respondent or upon petition of the Commission for enforcement. Thereafter, appropriate contempt proceedings may be brought in the particular court of appeals for violation of the court order. Either party may apply to the Supreme Court for review, by certiorari, of the action of the Circuit Court of Appeals.

Authority to enforce compliance with sections 2 (price discrimination), 3 (tying clauses and exclusive dealing arrangements), 7 (corporate stock acquisitions), and 8 (interlocking directorates) by the persons, respectively, subject thereto is vested: (1) in the Interstate Commerce Commission, (2) the Federal Communications Commission, (3) the Civil Aeronautics Board, and (4) the Federal Reserve Board, in their respective fields. The Federal Trade Commission enforces compliance where applicable to all other character of commerce.

It is the duty of the several district attorneys of the United States, under the direction of the Attorney General, to institute proceedings in equity to prevent and restrain violations of the act.

SANCTIONS AGAINST FOREIGN MONOPOLIES; FOREIGN TRADE

(A) Wilson Tariff Act

(28 Stat. 570 [1894], as amended 37 Stat. 667 [1913], U. S. C. 15:8–11)

Declares unlawful combinations or conspiracies in restraint of trade between persons engaged in the importation of commodities into the United States. Violation is made a misdemeanor and it may also be restrained in an equity proceeding by the Government.

(B) Antidumping Provisions of the Revenue Act of 1916

(Public Law 271, 64th Cong., 39 Stat. 798)

Revenue Act of 1916—Title VIII: Unfair competition: Makes it unlawful for a person, partnership, corporation, or association to import and systematically sell any article at a price substantially less than the actual market value or wholesale price of such article with the intent of destroying or injuring an industry in the United States, or of preventing the establishment of an industry within the United States, or of restraining or monopolizing any part of trade and commerce in such articles in the United States. Levies a special and additional duty upon any article produced in a foreign country and imported into this country under any agreement whereby the importer thereof or any other person shall be restricted in any manner in his using, purchasing, or dealing in the articles of another person. Authorizes prohibition during a foreign war, of imports from any country excluding articles from the United States. Violation is made a misdemeanor.

(C) Unfair Practices in Import Trade Provisions of Tariff Act of 1930

(Public Law 361, 71st Cong., 46 Stat. 703)

Section 337 defines unfair practices in import trade. This act declares unlawful unfair methods of competition and unfair practices in the importation of articles into the United States or in their sale, where the effect or tendency is (1) to destroy or substantially injure an industry efficiently and economically operated in the United States, (2) or to prevent the establishment of such an industry, (3) or to restrain or monopolize trade in the United States. The United States Tariff Commission is authorized to investigate violations, conduct hearings, and make findings to be transmitted to the President, who is directed

to exclude the articles concerned from entry into the United States whenever the existence of any of the foregoing practices has been established to his satisfaction.

(D) Webb-Pomerene Export Trade Act
(Public Law 126, 65th Cong., 40 Stat. 516)

Provides that the Sherman Act shall not apply to an association entered into solely to engage in export trade if such association is not engaged in restraint of trade within the United States, in restraint of the export trade of any domestic competitor even though outside the United States, or in any activity which substantially lessens competition within the United States. Permits stock acquisition of corporations solely in export trade unless competition within the United States will thereby be substantially lessened. Provides for annual fiscal and ownership reports of export trade companies to Federal Trade Commission. If after investigation by Federal Trade Commission an association is found to be in violation of this act, the Commission shall refer the matter to the Attorney General "for such action thereon as he may deem proper."

(E) Reciprocal Trade Agreements Act
(Public Law 316, 73rd Cong., 48 Stat. 943, as amended June 7, 1943, 57 Stat. 125; Public Law 66, 78th Cong.)

Adds part III (promotion of foreign trade) to the Tariff Act of 1930. Authorizes the President to enter into foreign-trade agreements to reduce tariffs when he finds that import restrictions are burdening foreign trade. Empowers the President to suspend the application of reduced tariffs when American commerce has been discriminated against by foreign countries, or because of the operations of international cartels.

GOVERNMENT PROCUREMENT AND DISPOSAL; PROHIBITION AGAINST COLLUSIVE BIDDING, ETC.

(A) Federal Property and Administrative Services Act of 1949
(Public Law 152, 81st Cong.)

Section 207 requires any executive agency at the beginning of negotiations for the disposal of any plant or other property costing $1,000,000 or more, or of patents, processes, techniques, or inventions, irrespective of cost, to seek the advice of the Attorney General. It shall be the duty of the Attorney General to advise the executive agency whether the proposal disposition of the property would tend to create or maintain a situation inconsistent with the antitrust laws. The execu-

tive agency must assist the Attorney General by furnishing him any requisite information it may possess essential to the Attorney General's determination. Nothing in the act modifies or limits the applicability of the antitrust laws to persons who acquire property under the act.

(B) Armed Services Procurement Act of 1947 (Public Law 413, 8th Cong., 62 Stat. 21)

Section 2 (b), (d): The declared congressional policy is that a fair proportion of the total purchases and contracts for supplies and services shall be placed with small-business concerns. If, in the opinion of any agency head, bids received after advertising evidence any violation of the antitrust laws he shall refer the bids to the Attorney General for appropriate action.

(C) Public Law 772, Eightieth Congress (62 Stat. 704)

Paragraph 441 prohibits the Post Office Department from granting contracts for furnishing supplies to any person who has prevented another from bidding on such contracts or engaged in price fixing. Violators shall be punished by fine and/or imprisonment; if the offender is a contractor for furnishing supplies, his contract may be annulled.

(D) Contracts for Carrying the Mail (R. S. 3850)

Bars letting of contracts for carrying mail to members of combinations to prevent bids.

(E) Public Law 81, Sixty-Fourth Congress (39 Stat. 161)

Section 7 authorizes substitution of other service by the Postmaster General whenever, in his judgment, a combination of bidders has been entered into to fix the rate for star-route service.

(F) Public Law 422, Sixty-ninth Congress (44 Stat. 766)

Section 2, paragraph 3, authorizes the Secretary of the Navy to construct aircraft at navy yards if bidders combine to restrict competition or if excessive prices for particular types, etc., of equipment be demanded.

GOVERNMENT POLICY IMPLEMENTATION

(A) Public Law 489, Seventy-ninth Congress (60 Stat. 438)

Trade-mark registration and protection: Section 33 allows establishment of violation of antitrust laws as a defense in trade-mark infringement suits.

(B) Panama Canal Act
(Public Law 337, 62nd Cong., 37 Stat. 567)

Section II of the Panama Canal Act forbids use of Panama Canal by ships owned, etc., by persons, etc., doing business in violation of the antitrust laws. Suit may be brought by any shipper or by the Attorney General.

(C) Public Law 299, Sixty-second Congress (37 Stat. 407)

Transfers following functions from the Department of Labor to the Bureau of Foreign and Domestic Commerce in the Department of Commerce: Ascertainment of what articles are controlled by trusts or other combinations of capital, business operations, or labor, and what effect said trusts, or other combinations of capital, business operations, or labor have on production and prices.

(D) Mineral Leasing Act of 1920
(Public Law 146, 66th Cong., 41 Stat. 448, as amended August 8, 1946, 60 Stat. 954: Public Law 696, 79th Cong., and June 3, 1948, 62nd Stat. 291; Public Law 576, 80th Cong.)

Section 27 provides for forfeiture of mineral lands or deposits leased from the United States if subleased, etc., to form part of an unlawful trust or to form the subject of any conspiracy in restraint of trade in the mining or selling of coal, phosphate, oil, oil shale, gas, or sodium.

(E) Public Law 129, Sixty-first Congress (36 Stat. 296)

Provides for forfeiture of oil or gas pipe-line rights-of-way in Arkansas if any corporation, etc., taking advantage of the act shall violate the Sherman Antitrust Act or any amendments to it.

(F) Public Law 151, Sixtieth Congress (35 Stat. 424)

Provides for forfeiture of coal deposit lands acquired from the United States in Alaska if any of the lands or deposits are controlled by unlawful trusts or form the subject of any conspiracy in restraint of trade in the mining or selling of coal.

(G) Public Law 216, Sixty-third Congress (38 Stat. 743)

Provides for forfeiture of coal-mining leases acquired from the United States in Alaska if any of the lands or deposits are subleased, etc., to form part of an unlawful trust or conspiracy in restraint of trade in the mining or selling of coal.

(H) Public Law 197, Sixty-sixth Congress (41 Stat. 594)

Provides for deportation (and denial of readmission) of aliens convicted of offense committed during August 1, 1914, to April 6, 1917, against the Sherman Act in aid of a belligerent in the European war.

PROCEDURE

(A) Judicial Code of Provisions

(Public Law 773, 80th Cong. [1948]; 62 Stat. 931, 928; U. S. C. 28:1337)

Section 1337 provides that the district courts shall have original jurisdiction of any civil action or proceeding arising under any act of Congress regulating trade or protecting trade and commerce against restraints and monopolies.

Section 1253 provides that any party may appeal to the Supreme Court from an order, granting or denying, after notice and hearing, an interlocutory or permanent injunction in any civil action, suit or proceeding required by act of Congress to be heard by a three-judge district court.

(B) Expediting Act

(Public Law 82, 57th Cong.; 32 Stat. 823)

Permits the Attorney General to file a certificate that a particular case arising under the Sherman Act or under similar acts is of general public importance. Thereupon hearings will be expedited, and the case will be promptly heard. Cases are to be tried before three judges in the circuit (one must be a circuit judge) and will be certified to the Supreme Court for review in event of divided opinion. Appeal from final decree of the circuit court may be taken within 60 days.

When a quorum of Justices of the Supreme Court is lacking by reason of disqualification, equity cases appealed from district courts under the Expediting Act are to be certified to the circuit court of appeals of the circuit where the suit was brought, where a three-judge court's decision is final.

(C) Immunity Provision of 1903

(Public Law 115, 57th Cong.; 32 Stat. 903; U. S. C. 15:32)

Provides that "no person shall be prosecuted or be subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in any proceeding, suit or prosecution under . . . [the Sherman Act, and all acts amendatory thereof or supplemental thereto]," but no person testifying shall be exempt from prosecution or perjury.

(D) Act Defining Right of Immunity
(Public Law 389, 59th Cong.; 34 Stat. 798; U. S. C. 15:33)

Provides that the provisions of law granting immunity to witnesses in antitrust suits shall be limited to natural persons.

(E) Publicity in Taking Evidence Act
(Public Law 416, 62nd Cong.; 37 Stat. 731; U. S. C. 15:30)

Provides that the hearings before any examiner or special master appointed to take testimony in equity suits brought by the United States under the Sherman Act shall be as public as trials in open court.

(F) Section 20 of Clayton Act
(38 Stat. 730, as amended; U. S. C. 29:52)

Limits issuance of injunctions in labor disputes.

(G) Norris-LaGuardia Act
(Public Law 65, 72nd Cong.; 47 Stat. 71; U. S. C. 29:105)

Section 5 of the Norris-LaGuardia Act provides that certain concerted acts of labor disputants shall not be enjoinable as an unlawful combination or conspiracy.

* * * *

SPECIAL REGULATORY ACTS

Due to the comprehensiveness of many of these statutes only a general statement can be included. . . .

(A) Civil Aeronautics Act of 1938
(52 Stat. 1001, 1002, 1003, 1005, 1025; 49 U. S. C., secs. 488, 489, 491, 494, 592, 647, and 648)

Creates the Civil Aeronautics Authority and the Civil Aeronautics Board and regulates the consolidation, merger, and control of air carriers. Relieves persons who are parties to agreements approved by the CAB from the operation of the antitrust laws; authorizes CAB to issue cease-and-desist orders against unfair methods of competition in air transportation.

(B) Interstate Commerce Act
(54 Stat., secs. 908 and 909; 62 Stat. 472; 49 U. S. C. 5 (11) and 5 (b))

Section 5 relieves from the operation of the antitrust laws persons who are parties to agreements which are approved by the Interstate Commerce Commission.

The Commission possesses important regulatory powers over common carriers, motor carriers, coastwise, etc., water carriers, freight forwarders, etc., with respect to rates, consolidations, or mergers, etc.

(C) Communications Act of 1934
(57 Stat. 6; 48 Stat. 1087; 47 U. S. C. 222 [b], 222 [f], 313)

Creates the Federal Communications Commission and provides for regulation of wire and radio communication. Declares antitrust laws applicable to the manufacture and sale of and trade in radio apparatus and devices entering into or affecting interstate or foreign commerce and to interstate or foreign radio communications.

(D) Federal Reserve Act
(41 Stat. 378 and 1145; 12 U. S. C. 611 and 617)

In authorizing formation of corporations to engage in foreign banking and financial operations, prohibits price fixing in connection with commodities handled.

(E) Federal Power Act
(41 Stat. secs. 168 and 1070; 16 U. S. C., secs. 803 and 803 (h))

Creates a Federal Power Commission and empowers it to issue licenses for developing water power. Prohibits agreements to limit the output of electrical energy, to restrain trade, or to fix, maintain, or increase prices for electrical energy or service.

(F) Public Utility Holding Company Act of 1935
(49 Stat. 803; U. S. C. 15: 79 to 79z–6)

Grants to the Securities and Exchange Commission supervision of the purchase and sale of utility properties, and other assets by registered public utility holding companies and their electric and gas utility subsidiaries, and approval of their reorganizations, mergers, and consolidations.

(G) Merchant Marine Act of 1936
(49 Stat. 2014; U. S. C. 46: 1224, 1227)

Grants important regulatory powers to the United States Maritime Commission extending to all common carriers by water engaged in foreign commerce of the United States. The Commission's approval of agreements between common carriers by water subject to its jurisdiction exempts such agreements from the operation of the antitrust laws.

(H) COMMODITY EXCHANGE ACT
(42 Stat. 1000, as amended, 49 Stat. 1491; U. S. C. 7:1 *ff*)

Makes unlawful attempts to manipulate prices of commodities or attempts to corner any commodity

(I) FEDERAL ALCOHOL ADMINISTRATION ACT
(49 Stat. 977 as amended; 27 U. S. C. 205 *et seq.*)

Provides for the regulation of interstate and foreign commerce in distilled spirits, wine and malt beverages. Prohibits exclusive outlets and purchasing arrangements with retailers by acquiring interests in retail premises or other unfair practices; prohibits interlocking directorates except when approved by the Administrator.

(J) PACKERS AND STOCKYARDS ACT, 1921
(42 Stat., secs. 161 and 168; 7 U. S. C., secs. 192 and 225)

Provides for the regulation of interstate and foreign commerce in livestock, livestock products, dairy products, and poultry products. Declares illegal monopolies, trade restraints, price manipulation or control, and other unfair trade practices in such industries.

(K) PERISHABLE AGRICULTURAL COMMODITIES ACT, 1930
(46 Stat. 531, as amended; 7 U. S. C. 499 [a] and 499 [r])

Provides for licensing and regulation by the Secretary of Agriculture of certain persons dealing in perishable agricultural commodities, including fresh fruits and vegetables; defines and prohibits unfair, discriminatory and deceptive trade practices.

(L) FISHERIES COOPERATIVE MARKETING ACT
(48 Stat. 1213, 15 U. S. C., secs. 521 and 522)

Declares the legality of fishing cooperatives; however, the Secretary of Interior is authorized to issue cease-and-desist orders if interstate or foreign commerce is restrained or monopolized.

(M) ATOMIC ENERGY ACT OF 1946
(60 Stat. 755, U. S. C. 42: 1801–1819)

Creates an Atomic Energy Commission and grants it broad regulatory powers with respect to fissionable materials. Directs the Commission to refuse licenses or to establish conditions in instances where monopolies or restraints of trade might be fostered.

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SOME METHODS OF UNFAIR COMPETITION

JOHN MAY

THE SPECIFIC COMPETITIVE MALPRACTICES condemned by the [Federal Trade] Commission are as follows:

PRODUCT

Results

Misrepresentation of the therapeutic value of drugs and remedies sold to cure some specific disease or a multiple number of diseases.

Failure to disclose the harmful effects of drugs, devices, or courses of instruction on the human physiology.

Falsely representing the results to be obtained through use of product or service.

False representation that incomplete training will develop an expert.

Misrepresenting ability of an individual to acquire training in short time, with little or no background.

Exaggerating claims of possible earnings after a course of instruction.

Exaggerating potentialities of products or fields of endeavor.

Value

False and misleading advertising concerning origin, quality, purity, attributes, results, or any other aspect so as to deceive the public.

Falsely representing the worth of a product or service by out-of-date testimonials or fictitious testimonials.

Origin

Presenting products as having domestic origin when made abroad and imported.

Presenting products made domestically to be of false origin.

Falsely representing that goods are government surplus.

Representing falsely that product came from area famous for its quality in this product—Pennsylvania oil.

Approval

Falsely representing governmental approval of the product of service.

Falsely representing goods to have been produced according to a physician's prescription and approval.

Quality

False and misleading advertising, concerning origin, quality, purity, attributed results, or any other aspects so as to deceive the public.

Falsely representing that seller conducts a laboratory to test his products.

Representing through trade name a lower quality commodity as a higher priced level.

Representing product as being made to conform to government specifications to increase its sales value.

Representing product as being "wool," "sterling" or "fur" when only partly so composed.

Representing product has passed inspection of testing agency when such is not true.

Falsely representing goods to be of high quality through so-called scientific advertising not understood by the layman.

Misrepresenting the quality of the product through the use of misleading trade name.

Character

Falsely representing the product to be something other than what it is.

Representing fabrics and garments to contain fibers not contained therein.

Misinformation

Representing goods of lower quality as higher in quality through simulation in production. Fabrics were made to appear as fur.

Misbranding of products to mislead the public.

Misrepresenting product or service pictorially.

Misrepresenting the newness of a product.

FIRM

Function

Representing that a distributor is a producer selling direct to consumer with resultant savings.

Connection

Falsely representing to be connected with some well-known organization that is really a competitor.

Falsely representing a private profit organization is connected with some non-profit group, such as a veteran's group, Red Cross, etc.

Falsely representing important and well-known personnel connected with the organization.

BUSINESS TACTICS AND ETHICS

Misinformation on Product or Service

Advertising symptoms of diseases falsely and insisting that a given remedy will cure them.

Falsely representing an offer of employment by advertising a service in help-wanted columns.

Misrepresenting methods of merchandising as factory to wearer.

Misrepresenting technical processes that can be interpreted only through expert knowledge.

Falsely representing approval of the Federal Trade Commission in advertising.

Falsely representing employment opportunities, earnings, promotions, etc.

Misrepresenting earnings, holdings, income, and prospects to encourage the sale of stock.

Falsely representing any connection with the government.

Simulation

Simulation of competitor's trade name, product, advertising, or attempt to pass off goods as those of another concern.

Concealment

Concealment of inventory as regular by offering it at special sale.

Distribution of old product under a new name.

Distribution of old product falsely claimed to be revised and up to date.

Using containers marked with content over and above that actually contained.

Discrimination

Discrimination between persons and prices.

Representing falsely that offer is made only to a limited class or number of persons.

Coercion

Threats or intimidation of competitors of any kind to hinder competition.

Retailers, wholesalers, or jobbers threatening each other with loss of markets unless aid is forthcoming in establishing maintained prices.

Retailers attempting to force wholesalers to guarantee them against price declines to make effective their price maintenance.

Threats to producers to join an association and conform to the association price policy or to prevent the producer from selling to the industry.

Boycotts of sellers or buyers to force conformance to collusive price maintenance.

Coercion against competitors to maintain uniform or minimum prices.

Combination and Conspiracy

Conspiring with competitors to maintain uniform or minimum prices.

Combinations of competitors to divide the market by zoning or volume of business.

Combinations to maintain price through identical cost systems, price lists, guides, etc.

The use of the basing point system to create identical delivered prices of all competitors.

Allocations of contracts through pools to limit competitive bidding.

Tying agreements on sales to purchase goods together to get the product desired.

Bribery

Bribing employees of customers to obtain or retain the sales made to them.

Bribing employees of competitors to secure information on processes or customers.

Gambling

Use of lottery devices and schemes for the sale of goods.

Supplying dealers with lottery devices for merchandising.

Exclusion of Competitors

Making disparaging claims as to competitor's product, mode of business, or customers.

Shipping goods to persons who have not placed orders and agreeing to help them sell the same in order to exclude competitor's goods.

The maintenance of exclusive dealer contracts to eliminate competition.

Disparagement of competitor's product to build up sales volume.

PRICE

Methods of Sale

Representing goods bought through regular channels as bought at auction, foreclosure, fire sale, etc., and now offered at a very low price.

Advertising to imply false prices through composition of the advertisement itself.

Selling goods below cost to drive competitors out of the business.

Representing goods or services as "free" that are really included in the sale price.

Discounts and Refunds

Falsely representing to purchasers refunds that actually do not exist.

Representing a deferment of part of sale price when full and regular price has already been charged.

Misrepresentation of real price through fictitious discounts.

Discounts, rebates, allowances and fees awarded to discriminate in price between buyers.

Guarantee of refunds which are not actually available.

Misrepresenting price as reduced and special for limited time only, when price is regular.

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A CONGRESSIONAL REPORT ON LOBBYING

Every democratic society worthy of the name must have some lawful means by which individuals and groups can lay their needs before government. One of the central purposes of government is that people should be able to reach it; the central purpose of what we call "lobbying" is that they should be able to reach it with maximum

impact and possibility of success. This is, fundamentally, what lobbying is about.

At first glance, it might appear that lobbying is the most thoroughly investigated and completely understood area of American politics. Actually, however, quite the reverse is true. Although committees of Congress have conducted spectacular investigations of lobbying activities on three other occasions in the past forty years, the true extent and cost of large-scale lobbying and its proper place in our representative system remained to be charted. This is less the fault of these earlier investigations than it is of the fact that the scope of lobbying is constantly expanding. Lobbying is not generally understood because it evolves too quickly for periodic congressional investigations to keep fully apace of it. As a result, public understanding of the problem is inevitably in arrears, and the interest which congressional investigations first generate soon lapses into indifference. This is basically what has happened since 1935 when the last major inquiry was held; public interest has waned and lobbying has quietly come of age. It is to this situation that our investigation has been addressed. We have sought to catch up with lobbying as it is today.

Certain aspects of lobbying's recent development were particularly responsible for the creation of this committee in August 1949. Primary among these was the fact that the sheer weight of group pressures had increased enormously during and subsequent to the Second World War, reaching an unprecedented peak during the Eightieth Congress. In a very real sense, the impact of war solidly established lobbying as a major industry. Our national effort, entailing as it did far-reaching controls over the entire economy, prompted a hitherto unequalled mobilization of group interests of every conceivable kind. This mobilization was due partly to the necessity of organizing to meet the Nation's needs, and partly to a desire for protection and subsidy from a government which had these things within its power to give or to withhold. In either case, the important result was a marked increase in the number of organized groups having an active and continuous interest in shaping public policy to their own ends.

Not only was there a sharp increase in the number of groups intent on influencing government, but their effort was also more intense, more diversified, and more effectively financed than it had ever been before. Here again, the impact of the war was basic; for with profits, wages, and taxes running at unprecedentedly high levels it was nothing more than good business to spend freely to protect one's self from adverse legislation or administrative rulings—particularly when the costs were chargeable to "operating expenses." Companies, sometimes with nothing

to sell, turned to institutional or editorial advertising in order to keep their names before the public, and, at no added cost, to present their views on labor legislation, public housing, or some other legislative issue. Contributions to "educational" leagues and foundations of every imaginable political color mushroomed. The entire pattern of pressure politics took on new dimensions during the war, and it has retained them ever since. By 1948, when the demand for this investigation began to mount, more groups were spending more money on more subtle methods of influence than at any previous time in our history. This heightened level of lobbying activity was primarily responsible for the establishment of this committee. The President, Members of Congress, various sections of the press, and thoughtful citizens agreed that lobbying had assumed new and unusual proportions, and that a thorough airing of the situation was urgently needed.

A second factor underlies our investigation and, we believe, sets it apart from earlier congressional inquiries in this general area. This is the first time that a congressional investigation of lobbying activities has been conducted within the context of a going system of registration. The passage of the Federal Regulation of Lobbying Act in 1946 and subsequent experience under this act have served to direct considerable attention to lobbying, and as a result of the act's operation in the last 4 years, there is currently available to Congress and the public a more detailed and systematic picture of group pressures than at any time in the past.

Ever since the act became effective, however, repeated questions have been raised as to its meaning and coverage. Numerous lobbyists and lobbying organizations have claimed that the act abridges their right of petition. Under the circumstances, of course, such allegations must be treated with suspicion. To other observers without any personal stake in the matter, the act is a well-intentioned first step which should be strengthened and made more effective.

* * * *

(*a*) *On defining lobbying.*—The term "lobbying" has been in common usage for approximately 100 years, and has been given many definitions. In the 1870's and 1880's, "lobbying" meant direct, individual solicitation of legislators, with a strong presumption of corruption attached. The lobbying of the 1880's demanded this kind of definition; the lobbying of today demands something quite different. Unfortunately, most present-day definitions are both inaccurate and unrealistic; they generally fail to recognize that modern pressure on legislative bodies is rarely corrupt, that it is increasingly indirect, and largely the

product of group rather than individual effort. With these limitations, the ordinary definition of lobbying provides an unsatisfactory basis for either congressional inquiry or statutory regulation.

Numerous State laws continue to define lobbying as "personal solicitation not addressed solely to the judgment" of legislators, or as attempts to secure money on the claim or pretense of being able to "improperly influence" them. In other States, definitions of lobbying as "bribery, promise of reward, intimidation, or any other dishonest means" of attempting to influence legislators still remain on the statute books or in State constitutions.

The discussion of lobbying in *Corpus Juris Secundum* is based on an equally narrow view of the subject:

> The term "lobbying" has a well-defined meaning in this country, and signifies to address or solicit members of a legislative body in the reception hall or elsewhere with the purpose of influencing their votes. Presentation by argument in a public and legitimate manner of the injurious effect proposed legislation will have on a particular business does not constitute lobbying.

Dictionary definitions are similarly limited in scope. Webster's *New International* tells us that lobbying is "to address or solicit members of a legislative body in the lobby or elsewhere, as before a committee, with intent to influence legislation." With the passage of the Regulation of Lobbying Act in 1946, numerous groups and persons claimed this kind of definition as their own in an effort to escape full disclosure under the act.

* * * *

As noted above, our investigation started with an existing lobbying law on the books. The framers of that statute, The Federal Regulation of Lobbying Act, did not use the word "lobbying" anywhere in the act except the title. Instead, they referred to attempts to influence the passage or defeat of legislation for pay or any consideration. Our Committee regards all such attempts as "lobbying" and has generally so used that word during our investigation.

In the final analysis, there are only two practical gauges of lobbying activity—intent and some substantial effort to influence legislation. The means employed are secondary, and any attempt to define lobbying by listing specific methods of influence is inevitably and almost immediately out of date.

These criteria do not define lobbying, but they do set forth the essential conditions without which lobbying does not exist. We feel that

these are the only criteria inclusive enough to span the entire present system of pressure politics. They are the only criteria which would have enabled this committee to lay the full facts before Congress and the people.

We firmly believe that, in any inquiry into the process of influencing the passage or defeat of legislation, it is important to utilize a functional approach. Variations in bookkeeping technique or the mere self-serving application of labels by special interest groups should not be permitted to conceal the true nature of their activities. The thing that is most significant in attempts to influence legislation is the expenditure of money, whether it be used for direct contact of legislators, direct communication with legislators, or in efforts to stimulate grass-roots pressure so that members of organizations and members of the general public will communicate with legislators in support of a particular legislative program.

(*b*) *The extent of lobbying activity.*—Whether defined narrowly or broadly, lobbying is extremely difficult to measure objectively. The members of this committee knew, as all Members of Congress cannot help but know, that lobbying in the past few years has become more widespread and intensified than at any other time in our history. We recall the Taft-Hartley issue, OPA, rent control, public housing, and a whole host of other recent issues which have been the subjects of terrific pressure campaigns. We knew then as we know now that intense efforts and many millions of dollars were expended in connection with these measures; but these are things which cannot be computed with mathematical precision.

A few useful gauges of the extent and cost of lobbying are available, however. Primary among these are the sums reported and registrations made under the Federal Lobbying Act since 1946. The following analysis summarizes the quarterly reports of lobbying contributions and expenditures filed by organizations and groups pursuant to section 305 of the act. More than $20,000,000 has been reported under another section of the Lobbying Act (sec. 308) for the same period. Most of this amount is not included in the figures in the table [on page 589].

Seventy-five million dollars for 3½ years of lobbying is a large and impressive sum but it does not begin to reflect all that is actually collected and spent in efforts to influence legislation. Many groups submit only fragmentary reports in which they omit the costs of publications, public relations, and advertising directly related to public issues. The National Association of Home Builders, for example, has not reported the costs of its public relations program which it estimates has aggre-

Analysis of reports filed under sec. 305 of the Federal Regulation of Lobbying Act

Quarter	*Number filed*	*Original filings* [2]	*Quarterly contributions*	*Quarterly expenditures*
1946:				
Third	46	...	$446,049.21	$729,377.81
Fourth	92	..	1,166,686.41	1,567,903.40
Total	138	99	1,612,735.62	2,297,281.21
1947:				
First	157	..	3,724,622.43	1,370,921.92
Second	157	...	4,563,358.81	2,520,692.48
Third	142	...	3,066,790.37	1,398,351.77
Fourth	185	..	3,470,668.65	1,679,930.91
Total	642	152	14,825,440.26	6,969,897.08
1948:				
First	237	...	3,334,559.06	1,973,250.85
Second	263	..	3,469,780.51	1,910,837.41
Third	217	...	[1] 3,920,963.86	[1] 1,629,349.06
Fourth	254	...	[1] 7,662,565.59	[1] 2,331,231.54
Total	971	146	18,387,869.02	7,844,668.86
1949:				
First	290	..	[1] 8,896,775.22	[1] 2,294,897.38
Second	291	...	[1] 4,541,146.69	[1] 2,382,031.63
Third	272	...	[1] 3,162,816.32	[1] 2,670,434.60
Fourth	274	..	[1] 3,768,765.84	[1] 2,972,307.04
Total	1,127	98	20,369,504.07	10,319,670.65
Grand total	2,878	495	55,195,548.97	27,431,517.80

[1] Includes amounts contributed and expended in previous quarters but not theretofore reported.

[2] Groups filing reports for the first time.

gated $250,000 in the past few years. Many more groups do not report at all, taking the position that they are exempted by the "principal purpose" clause of the Lobbying Act, or that their agent's registration relieves them of the responsibility of reporting. Witness the fact that the 2,878 quarterly reports were submitted by only 495 groups, a fractional proportion of the permanent national organizations which are vitally interested and continuously active in seeking to shape public policy. In still other cases, a national organization, such as the National

Association of Real Estate Boards, or Americans for Democratic Action, will file reports while the State and local adjuncts will not, this despite the fact that legislative operations on the several levels are inseparably meshed. Many other types of nonreporting and partial reporting under the Lobbying Act could be added.

In sum, these reported figures give us a very incomplete picture of the realities of lobbying. To accept this picture as complete would be equivalent to saying that no money is gambled on horse races other than that paid through the pari-mutuel windows in the 27 States which have legalized such gambling. If the full truth were ever known, this committee has little doubt that lobbying, in all its ramifications, would prove to be a billion-dollar industry. This figure is not offered in an effort to shock the complacent but as a sober estimate. Consider the costs of letter and telegram campaigns; the thousands of pages of institutional advertising; the purchase and distribution of millions of highly charged books and pamphlets on public issues; the salaries of executives, lawyers, and publicists; the operating budgets of all the thousands of organizations throughout the Nation whose central purpose is to influence what Government does—all of these costs and many more are chargeable to lobbying, whether we like the word or not.

In the same sense that filings under the Lobbying Act grossly understate the number and expenditures of pressure organizations, so too do individual registrations fail to reveal the actual number of persons actively engaged in seeking to influence the governmental process. Over 2,000 persons have registered as lobbyists since 1946, but in many cases these registered lobbyists are merely Washington representatives for national organizations having large, well-paid staffs throughout the country. For example, the CIO national organization has only four registered lobbyists, and the American Medical Association has only seven. Once again Congress and the people are not in full possession of the facts.

Although no exact conclusions are possible as to the number of lobbying organizations and lobbyists, or as to the money which they expend to influence legislation, filings under the Lobbying Act do yield an indication of which groups are mounting the most insistent and well-financed pressure campaigns. This picture varies, of course, from one year to the next, depending somewhat on the issues at stake. In 1949, for example, the American Medical Association led all other registered groups by reporting lobbying expenditures of $1,522,683; but organized business and business-supported groups reported total disbursements of $4,141,480. Of the 35 organizations which reported lobbying expenditures of over $50,000 in 1949, 22 were purely business

or trade groups and 2 others derived almost their entire support from corporate or business contributions.

So far as reported expenditures for lobbying are concerned, organized business far outspends other interests. This fact, however understandable, points to a situation which tends to undermine the props on which American thinking about lobbying has traditionally rested. We believe lobbying to be every man's right. But some men are more able to make their rights meaningful than others. In practical terms, this has meant that those interests with the most to spend for protection have proclaimed "lobbying for all men" as an almost sacred article of faith. It is not unlike the elephant shouting "Everybody for himself," as he stomps up and down among the chickens.

The pressure potential of American business is all the more strikingly illustrated by the replies to an inquiry which the committee addressed to approximately 200 corporations, labor unions, and farm groups. The information contained in these replies is the subject of separate committee reports. The following table is a summary of the corporation respondents' expenditures relating to efforts to influence legislation directly and indirectly during the period January 1, 1947, to May 31, 1950:

Nature of expenditure	*Number of corporations listing expenditures*	*Amount expended*
Travel to Washington	66	$227,256.62
Maintenance of Washington office	7	346,807.65
Distribution of printed matter	65	382,679.77
Printing costs	65	1,811,839.24
Advertising	31	2,013,369.72
Contributions	125	26,941,452.57
Other	37	406,787.27
Total		32,124,835.38

This total dwarfs the $776,466.07 reported under the Lobbying Act by those 37 of the respondents that file reports. The pressure groups continue to receive large contributions, but increasingly the great corporations are mounting their own major lobbying efforts.

(*c*) *Money for lobbying.*—The late Senator Thaddeus Caraway once stated that 90 per cent of the groups represented before Congress were what he called fake organizations, groups which consisted of little more than a letterhead and a promoter busily engaged in lining his own pockets. While this estimate may have been accurate at an earlier

time, it is ~~not~~ in accord with the present realities. Soliciting money for lobbying is much more than a device by which a few imaginative opportunists can gull the unwary. Lobbying is an important and usually an honest business, and it is a business which runs on money.

The means by which groups raise funds for lobbying are infinitely varied but there are two general patterns which cover the fund-raising activities of most lobbying organizations. The first might be called "orthodox" solicitation, largely because it conforms to standard practice among the well-established, membership groups. Labor unions, trade or business associations, farm groups, veterans' groups, and professional societies are typical membership groups, that is, groups where membership rests on the basis of occupation, profession, service, or trade. Fund-raising by these organizations is usually simple and straightforward. Membership dues are ordinarily the largest source of funds, and are assessed at the rate of X dollars a year, as they are by most organizations in this category, or they may be assessed according to a standardized sliding scale.

* * * *

Actually, most groups do not have to use direct pressure in obtaining funds for the group's lobbying activities, for in most cases the members do not have to be sold on the job that the group is doing for them. They believe in the group and they identify themselves with the group's purposes, even though they have taken no great part in formulating them. Most members do not have to be pressured for contributions; they give freely and enthusiastically not only of their money but often of their time and effort as well. Once a group has convinced its members, raising money is fairly simple.

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(*e*) *Techniques of lobbying.*—Lobbying is as natural to our kind of government as breathing is to the human organism, and it is almost equally complex. Part of this complexity springs from the fact that there are no significant interests in our society—economic, social, or ideological—which do not in one way or another seek something from government. With so many conflicting voices clamoring to be heard, the only means of securing a full hearing has been to constantly find new techniques by which your views can be presented more effectively than your competitor's. The demands of vigorous competition have thus made lobbying an exacting and an ever-evolving profession. The encyclopedia of lobbying practices needs frequent supplements to keep it up to date.

And they had best be cumulative supplements; for while lobbying techniques are continually being streamlined, the old stand-bys of pressure tactics are only slowly relinquished. New methods are added but old ones are not dropped. For example, direct contacting of legislators, the critical component of any traditional definition of lobbying, is still a common practice. Individuals and groups very properly seek to apprise legislators directly of their views on public issues. The variations on this old practice are, of course, endless.

Some groups make their views known by letters, telegrams, and phone calls. Others depend largely on personal contact with Members of Congress, and still others think that they can best serve their cause by organizing delegations for marches on the Capitol. The Civil Rights Congress has often used this last approach and has on numerous occasions sponsored mass train trips to Washington for the purpose of what its officers call "speaking on . . . legislation."

Members of Congress are used to being sought out in their offices, in their homes, in the corridors of the office buildings and of the Capitol, in the cloakrooms and restaurants, on the floor of the Chamber itself. They expect and welcome letters, telegrams, and telephone calls from constituents and from those outside their districts as well. In an age where the actions of Congress directly affect the lives of so many, legislators depend on these communications in a very real and immediate way. They are both the pipelines and the lifelines of our kind of representative government.

But such statements and comments are not always as spontaneous, original, or genuine as they appear. Some tend to degrade the right of petition into a solemn-cynical game of blind man's buff, a test of wits between the lobbyist and the legislator. Representative Clarence Brown remarked jocularly during an early hearing that he could smell such inspired pressure letters without opening the envelopes; but it is not always easy to separate the real expression of opinion from the contrived one.

* * * *

VI. CONCLUSIONS

Practical causes of lobbying

For all the high gloss with which discussions of lobbying are usually adorned, it remains a very practical problem with a number of very practical causes. First among these is our long and splendid tradition of free association. Americans are free to band together as they choose, subject only to the requirements of public safety. This tradi-

tion, compounded with the high degree of group consciousness and organization typical of any modern industrial society, has provided the raw materials from which our present system of lobbying has been built.

The tools with which this system was built were the constitutional guarantees of political freedom, especially the right of petition, of which lobbying is usually regarded as the most important expression.

The conditions in which a highly developed system of pressure politics could flourish were provided by two other unique features of our governmental arrangements. First, our political parties have grown progressively more loosely controlled and undisciplined. Pressure groups thrive on the inability or unwillingness of political parties to exercise the powers of government which they have lawfully gained at the polls. The advantages of this situation to the lobby group are obvious: lack of cohesion in the parties enables well-organized private interest to secure some of the advantages of political power without having to submit to the democratic electoral process by which this power is usually attained.

The necessarily complex structure of our Government, with its separation of powers, checks and balances, and bicameral legislature, has also contributed to the growth of lobbying. Complex government inevitably means government with bottlenecks at which pressure can be quietly and effectively applied. Thus the great pressure campaigns of recent years have relied heavily on the tactics of attrition and delay at every critical spot in the legislative process. The prevention of governmental action, and this is the aim of many lobbies, is relatively easy under these cricumstances.

Finally, lobbying has reached its present proportions because our Government has always been sensitive to private demands. One successful piece of special pleading bred another and the entire system developed gradually but with irresistible momentum.

Theory of lobbying

While these practical causes are paramount, there are several theoretical considerations which underlie the present high level of lobbying activity. We lack and have always lacked any established theory as to the proper relationship and balance between private power and the power of government. Lacking such an established theory, we have rested our thinking about lobbying on two premises: first, that lobbying is not a problem of who is to exercise political power, but is, rather, a matter of expressly granted individual rights; and, second, that lobbying is no problem in a free society because one interest can

be depended upon to "cancel out" another. This process of cancellation and compromise, it is said, should produce responsible public policy.

As to the first premise, the right of petition is cited as both the cause and justification of lobbying, and rightly so. Organized groups of interested citizens have an important informational and representative role to play in our kind of government. Citizens can and should exercise their right of petition individually and through organized groups. Without this constitutionally guaranteed right of petition, our kind of free government could not exist. But we often fail to recognize that while lobbying is a necessary right which should not in any way be restricted or abridged, it is a right which is not exercised for itself alone. People and groups seek to influence legislative policy because they hope to gain thereby and not because they want to keep their rights from becoming flabby for want of exercise.

So it is that, in their public utterances, lobbyists show the utmost attachment to constitutional rights. Privately, however, they often admit that rights to them are only a means to an end and not an end in themselves. As one of the most expert of them said, ". . . organized power is the only thing that Government can take into account."

It is also a bitter paradox that the right of petition, one of the highest rights which democracy can bestow on a free people, is sometimes put to its most effective use by persons who are far from devoted to the principles of democracy. "I do not believe in democracy. I think it stinks," wrote Herbert U. Nelson, of the. . . . Yet Mr. Nelson's organization was and is spending hundreds of thousands of dollars for lobbying, something which can only be done in a democracy such as ours.

The second major premise, that one interest will cancel out another, has been a staple of American political thinking since James Madison wrote his Federalist Paper No. 10. Unfortunately, Madison's prophecy has never matured; instead of canceling out, the pressures on Government have become cumulative. We referred earlier to the growing joint effort in lobbying, the long-run tendency of which is to break down the barriers against private domination of State power. Even if pressure groups did compete instead of join forces, the advantage in lobbying would always lie with those interests which were best organized, best financed, and had the easiest access to mass media of communication. Organized business has always gained the most from lobbying because it has had the best organization, the most money, and the readiest access to publicity. It has had, in addition, the great advantage of seeking generally to prevent rather than encourage action by broadly based popular government. Given the strategic bottlenecks of our legislative procedure, it is far easier to obstruct than it is to create.

Could responsible public policy result from this theoretical canceling of group interests? It is not likely. While this process seems neat and automatic, it simply does not operate as it is supposed to. Even if it did, it would represent a degrading conception of democratic politics in which the highest function of government would be to yield to the strongest pressure. Absolute responsiveness to group interests is one thing, but truly responsible representative government is quite another.

All of these questions inhere in the traditional American approach to lobbying. We raise them only to indicate that while lobbying is natural in our system, and should not be curbed, the outer limits beyond which lobbying is an offense against the welfare of the whole community have not begun to be charted.

The costs of lobbying

We seldom stop to consider the legislative costs of lobbying, perhaps because it is difficult to say when a measure is the product of lobbying and when it is an accurate reflection of real public need. Still 150 years of congressional history provide dozens of clear cases in which well-organized pressures have been instrumental in the enactment of ill-considered, inequitable, or vastly unpopular legislation. In many other cases, private pressures have been responsible for the defeat, delay, or emasculation of measures having overwhelming public support. With Congress daily assuming new and complex responsibilities, the dangers of increased pressure on the legislative process are very real.

What might be called the social costs of lobbying are even more serious, although just as seldom recognized. Our leadership in a troubled world demands clear thought and common effort; but can we maintain this leadership in the face of the social tension, the group conflict, the "me first" attitude of which mass lobbying is both a cause and a symptom? The lobby-as-usual philosophy which prevailed in some quarters during World War II should serve as a grim reminder that even the deadliest of national perils does not put an end to selfish interest. As we enter the new world crisis, this experience is both a sobering lesson and an ugly portent.

The lobbying situation is basically a reflection of the state of our economy. As the management of this economy has drifted into fewer and fewer hands, so too has pressure on the legislative front been sharply intensified. The giant concentrations of corporate wealth which the Temporary National Economic Committee found to dominate the prewar economy have developed since at an accelerated pace. It is inevitable that such great concentrations of economic power should seek to extend their power to the political field as well, and we count

this fact as one of the most serious problems which large-scale lobbying poses for our kind of easygoing institutional structure. Economic power provides one of the essential raw materials for successful pressure politics; the greater the power, the larger are the possibilities of success. And so to the extent that some groups are better endowed than others, there is a disparity in the pressure which these groups can exert on the policy-making process. As we said earlier, "lobbying for all" may be a sacred right but it is a right which some men can make more meaningful than others. It is said, for example, that the individual consumer and the billion-dollar corporation have equal rights before the law, but are they equal before the lawmakers?

This, then is the problem: the great political imbalance between tightly organized economic power blocs, such as big labor, big business, and big agriculture, and more casually organized interests and a loosely patterned state. This imbalance is reflected in lobbying activities as it is in other aspects of our national life.

We also count as "social costs" of lobbying the ideological conflict and public confusion which has already begun to result from the growing use of a charged public opinion as an instrument of pressure. Men need slogans, catch-phrases, and generalizations to reduce their experience to understandable terms. But these slogans should not be a substitute for thought; when they are, men have lost the first part of their ability to govern themselves. Yet this is precisely what the pressure groups and their public relations experts are about. Organizations seeking to protect a privileged status for their members at the expense of the general welfare of all Americans use terms like "socialism," "statism," and "welfare state" to forestall rational analysis of legislative proposals which they oppose. We are prepared to risk our national existence against totalitarianism, yet there are those among us who live by the totalitarian principle of the great distortion, endlessly repeated. Political freedom cannot live in an atmosphere of such hysterical oversimplification.

There are finally the economic costs of lobbying to be considered, and these are staggering. The costs of 150 years of relentless raiding of the Public Treasury are beyond estimate, but we do know that the present demands of the great interests total far more than the Nation can afford. The people must also bear the costs of lobbying as well as pay for its end results. It is ultimately the people who pay for the big front and the high-pressure campaigns that the pressure boys put forward.

* * * *

THE ALTERNATIVES

We have sought to express above our conviction that the present system of pressure politics has assumed extraordinary proportions. We have also tried to show that this system must continue to expand, and that this expansion may challenge the existence of representative government as we have known it. What is to be done? The constitutional right of petition must be preserved, and no restriction should be imposed on legitimate lobbying.

A number of approaches to the problem have been suggested. Some of the more important of these are discussed below.

(1) It has been suggested, seldom with any clear outline for practical implementation, that Government should support those important interests which do not have adequate resources so that they can contend on an equal basis with better-financed groups. This approach might help solve the problem of the present imbalance between various groups, but it would ultimately result in more rather than less pressure on policy making; we are not persuaded that this would be desirable. There is, in addition, the difficulty of selecting some reasonable criteria on which such support could be based.

(2) Suggestions are frequently made that organized groups be given some formal place in the policy-making process. We already achieve something of this kind in the advisory councils to numerous administrative bodies and in the invitations extended to interested groups to appear before congressional committees on most major legislation. But we do not believe it would be wise to go beyond these steps. Again, there is a problem of choosing the criteria on which formal group representation should be based. In this respect, the experience of various European countries with official economic councils is not very encouraging. Would this not also be yielding to pressures rather than coping with them? Popular, geographic representation is basic in our system of government.

(3) Streamline the legislative and administrative process, for pressures thrive on Government when it becomes too complex for ordinary citizens to understand. This may point to at least a partial answer, and the Legislative Reorganization Act of 1946 and the work of the Hoover Commission indicate that useful first steps have already been taken to this direction. There still remains, of course, a considerable need for further improvements.

(4) We need stronger political parties and party discipline. This is basic. Much of the current onus placed on partisanship in politics overlooks the fact that if the parties don't accept responsibility the

pressure groups will move in by default. Lobbying is no serious problem in a society where the parties can make up their minds and live up to their commitments. A stronger sense of party cohesion may be difficult to achieve in the United States, for most Americans seem to like their parties as they are. Ultimately, however, responsible parties are an essential requisite of responsible government.

(5) We need more information on lobbying and lobbyists. This, at the moment, is the most feasible approach. Every group has the right to present its case, but at the same time Congress and the public have a right to know who they are, what they are doing, how much they are spending, and where the money is coming from—in a word, full disclosure of the relevant facts. Such disclosure is thoroughly in accord with our system and principles and has already received legislative recognition in the Regulation of Lobbying Act. What is needed is that this act be equipped to fulfill more effectively the purposes for which it was designed. We shall offer elsewhere a series of detailed recommendations and amendments by which we believe that the act can be brought to a higher level of efficiency. The act as it stands is a workable and valid piece of legislation. Our recommendations will be designed to eliminate some of the misconstructions that have hampered the operation of the act. The act does not seek to regulate but to inform. It works on the simple premise that Congress and the public have the right to full information on those who actively attempt to influence the decisions of government.

No one of these approaches alone is equal to the magnitude of the problem we face; but together, they are the first steps which must be taken if special interest groups are not to ride roughshod over a public interest which may often be inarticulate.

There is a final catalyst which can cement these various approaches together into a solid and meaningful program. Prof. Stephen K. Bailey expressed it splendidly when he testified before the committee:

> This is not a job for visionaries, although vision is needed; it is not a job for the calculating mind, although intelligence is needed; it is not a job for pressure groups, although the interest of every segment of our society must be weighed in the formulation of national and international policy. It is basically a job for people like yourself who know and understand the complexities and cross currents of political and economic pressures, but who are in a rare position to exercise moral judgments in the public interest over the conflicting claims of private groups.
>
> Such moral judgments constitute the real answer to the existence

of lobbyists. No registration law, no listing of connections and salaries in the *Congressional Record,* no system of party responsibility, by itself, can scratch the surface of the problem of controlling pressure politics. In the long run, a civilized morality is the sole key to the survival of democracy.

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MANU'S MAXIM OF TAXATION

MANU (who lived somewhere between 1500 and 1200 B.C.) was an Indian lawgiver who had this to say about taxation:

"Of the unequal partition of taxes the necessary consequence is a greater quantity of suffering than the same amount of taxes produce, if more equally imposed, because the pain of the man who pays too much is out of all proportion greater than the pleasure of the man who pays too little. To make the burden of taxes equal, it should be made to press with equal severity upon every individual. This is not effected by a mere numerical proportion. The man who is taxed to the amount of one-tenth, and still more, the man who is taxed to the amount of one-fifth or one-half of an income of 100 rupees per annum, is taxed far more severely than the man who is taxed an equal proportion of an income of 1000 rupees, and to a prodigious bigness more severely than the man who is taxed an equal proportion of 10,000 rupees per annum."

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THE TAXATION OF "EXCESS" PROFITS

THE KOREAN WAR and the rearmament program precipitated by it have raised anew the issue of the excess profits tax. In times of great national emergency, such as war, calling for greatly enlarged government outlays, it is recognized that some part of these heavier costs can most readily be met out of business taxes.

* * * *

The idea of an excess profits tax has a widespread appeal under present conditions.

In the first place, the very term—"excess profits"—implies something which is greater than it should be and therefore ought to be taken away, particularly in wartime. It conforms to the popular feeling that "no one should make a profit out of war."

Secondly, an excess profits tax falls, or at least should fall, heaviest on those companies whose profits are increasing and hence may be said to raise money "where it hurts the least." There is an argument for an excess profits tax as a temporary device in preference to a straight across-the-board levy which might work severe hardship on those companies whose profits are not increasing or are even decreasing.

In addition to legitimate arguments for an excess profits tax, there is of course always the pressure from demagogues and prejudiced groups who are ever ready to grasp a chance to "soak the corporations." The fact, moreover, that an excess profits tax falls upon only a relatively limited number of corporations, and thus is "hidden" from the population generally, makes it a tax that politicians easily find reasons for favoring. During the five years 1941 through 1945 when the excess profits tax was in effect, it was paid by an average of only 54,525 corporations annually, out of a total of 433,000 active corporations, or by only

1 out of 8. This meant that out of the total number of active businesses averaging 3,206,000, and including individual proprietorships and partnerships, the excess profits tax was paid by only 1 out of 60. This is just the kind of tax that politicians like.

Disregarding appeals to prejudice and political motives, what are the arguments against an excess profits tax?

The President, in his radio address of September 9, outlined three "hard, tough problems" that we must solve in order to do the defense job properly—(1) to produce the materials and equipment needed for defense, (2) to raise the money to pay the cost of the defense effort, and (3) to prevent inflation.

It is with points (2) and (3) that tax policy is primarily concerned. As regards point (2), it is clear that the excess profits tax can produce substantial amounts of revenue.

When it comes, however, to point (3)—the prevention of inflation—there is ground for dispute as to how well the excess profits tax meets the specifications. While this tax, like any other, is anti-inflationary to the extent that it enables the Treasury to cover its expenditures without borrowing, it has shown repeatedly the serious fault of encouraging corporate waste and extravagance. Business concerns, knowing that most of what increment in profits they make will be taken from them in taxes, tend to become lax in such matters as salary and wage increases and bonuses, over-manning of shop and office forces (with consequent intensification of manpower shortages), needless advertising, costly repairs on plant and equipment, expense accounts for entertainment, etc. It is suspected that one of the reasons why labor unions are so keen for the excess profits tax lies in the belief that wage increases will come along much more easily when employers can figure that the Government is footing the bill. The incentive for economy and efficiency is greatly lessened. All of this is inflationary and tends to accentuate the very evil which the tax is intended to suppress.

A second major weakness of the excess profits tax is the impossibility of arriving at any fair determination for each individual enterprise of what constitutes "excess" profits—either in wartime or peacetime.

Computation of a tax on "excess" profits requires, first, the determination of what are "normal" earnings, and the latter is a question on which general agreement can never be expected. In the excess profits taxes of World Wars I and II, the "base" earnings, which are wholly or partially exempt from that tax (but not from normal tax and surtax), were defined either as the average earnings of some specified prewar period, or the earnings that would represent a specified rate of return on invested capital.

While it may sound all right in theory to apply the tax to profits

in excess of some prewar period, say in the present instance the average of 1946-49, actually the problem is not so simple. By no means were all companies uniformly prosperous during that period, and for those which were encountering earnings difficulties the selection of such a base period would work real hardship. Application of the tax would be particularly onerous in the case of newly-established and rapidly-growing companies, which have little or no base period of earnings but under the law must "reconstruct" such earnings—as they might have been if the companies had been in business and had experienced the same cycle that was normal for their industries.

Nor are the difficulties eliminated by allowing as a "base" for fair return some specified rate of return on invested capital, inasmuch as the latter is affected by numerous technicalities involved in the original cost of assets, accrued depreciation charges, mergers and reorganizations, property write-downs and write-ups, recapitalizations, valuation of goodwill and other intangibles, contingency and other reserves, etc. Moreover, a rate of return regarded as reasonable for an industry or an individual company having a stable record of earnings might be inadequate for others subject to greater risk. The amount of capital required varies greatly among different kinds of businesses.

While the mere determination in any one year of corporate taxable income, as defined for tax purposes by statute and by Treasury regulations built up over a period of nearly forty years, is often a costly procedure that extends for months or years, it is elementary as compared with the determination of invested capital or normal base earnings.

In all this discussion of technicalities a basic consideration is the inability to differentiate between legitimate high earnings from valuable service rendered and actual excess profits. The maintenance of a strong America and the continued improvement in the standard of living over the long run depend upon the expansion of our industry through substantial investments in new productive capacity and in the development of new products and manufacturing processes. The "business as usual" corporation contributes nothing in this direction—it is the ambitious, growing corporation, willing to risk its capital and earnings exploiting new fields, which is primarily responsible for our progress and prosperity.

Yet it is the growing corporation which is the hardest hit by an excess profits tax. Its earnings will have been depressed during the base period by abnormally large expenditures, and trial and error operations, necessary in the development of any new product or productive capacity. As a result, its base period earnings will not be a fair measure of its earning capacity.

These considerations of the damaging effect of this tax upon initia-

tive, efficiency, and growth are of particular importance in view of the prospect that the emergency which we face is not short-range, but may last for years. The ability of this country to defend itself and to play its part in maintaining a peaceful world will depend upon our preserving the industrial leadership that has been our great safeguard in the past.

Relief provisions that have been written into previous excess profits tax legislation to take care of unusual hardship cases have been only partially successful, and often have merely added to the confusion. It will never be known how many man-hours of time on the part of business executives, accountants, lawyers, tax experts, and government employees have been expended in negotiations over the relief provision in the repeatedly amended Section 722 of the Revenue Act of 1940, and cases involving relief claims totaling $7 billion are still outstanding. In fact, when that Act was passed, there were cases still unsettled from the excess profits tax of World War I. Such delays are particularly hard on the small business man, who frequently cannot afford to keep up the fight and in the end has to settle for what he can get.

These are formidable difficulties, and if they do not warrant rejection of an excess profits tax, they emphasize the need for careful study by Congress in framing its terms and conditions.

Since it is impossible to eliminate the inequities and other defects of this tax, it becomes all the more necessary to exercise restraint and moderation in its application. In particular, we need to guard against the efforts of those who would employ this tax not merely to recapture extra profits accruing to business from the war program, but also to cut down profits arbitrarily regarded as "too high." The first is a legitimate objective of wartime taxation, difficult though it may be to carry out fairly and equitably in practice. The second would introduce a new and revolutionary principle of profit limitation into the American tax system.

The distinction is between a true "war profits tax" and a "high profits tax." As was pointed out by Edward H. Collins in the September issue of *Tax Review,* published by The Tax Foundation, the term "excess profits tax," especially when it is employed by politicians, doesn't always mean a "war profits tax" in the true sense at all. He goes on to say:

> Frequently it is used to describe a tax levied, not on the excess of wartime profits over prewar profits, but on all profits in excess of some arbitrarily selected "normal" or "fair return on investment." Authorities distinguish sharply between these two broad classifications

of excess profits taxes, which they define, respectively, as the "war profits" principle and the "high profits" principle.

The type of tax proposed by the group in Congress which sought to drive through an excess profits amendment to the Revenue Act of 1950 was not a "war profits tax" but a "high profits tax." Instead of a super-tax at very high rates applying only to earnings in excess of a pre-Korea average, it would have applied to all earnings above 75 per cent (later raised to 80) of such average. This super-tax would, of course, be additional to the taxes on all corporate income subject to normal tax and surtax, now raised to a total of 42 per cent for 1950 and 45 per cent for 1951, and to the increased personal income taxes on corporate income passed along as dividends to shareholders.

Thus, although advanced ostensibly to prevent "profiteering" out of the war program, such a super-tax would in fact reach down substantially below the level of earnings prevailing before Korea had ever burst into the news. By virtue of its low base, it would become in effect a device not only to limit war profits but to impose an arbitrarily determined ceiling upon corporation earnings generally. Senator O'Mahoney, leader of the Congressional excess profits tax advocates, expressed concern that "we are asked to delay a tax on excess profits of corporations which are reaching unheard-of levels," but failed to mention the fact that wage payments and national income generally are also reaching "unheard-of levels" and that the high corporation earnings which are a part of this picture are not being made on war contracts.

Adoption of the excess profits tax as a long-range proposition would be another blow weakening the enterprise system and hastening the trend towards socialism. For the enterprise system depends on incentive, and the excess profits tax singles out for its heaviest burdens those very companies which are the most efficient in holding down costs and which are pushing ahead most aggressively in developing new products and processes. All this goes back to the point mentioned earlier—that taxing to pay for a brief all-out war is an entirely different matter from taxing to pay for an expanded armament program that may continue for decades. In the kind of situation we face now, the preservation of the strength and vitality of our economic system is important not only for the future well-being of the people. It is just as important for victory as the armed program itself.

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AN EARLY INHERITANCE TAX (cir. 1396)

WHEREAS THE CUSTOM OF THE PARISH, used of ancient time, is that when any man or woman within the said parish (St. Just in Roseland in the county of Cornwall) dieth, the parson shall have the best garment of the person so dying in the name of a mortuary, and there died a woman called Desyra, widow of one Jakke-John, within the said parish, and the best garment she had, to wit, a red surcoat worth 6s. 8d., belonged to the parson by the custom aforesaid; this was carried over the body to the church . . . , when there came the said Alan with force and arms, to wit, with club and knife, within the churchyard of the said church, and took and carried away the garment, so [laid] over the said body, against the will of the said parson (Thomas Raulyn) . . .

(As also with the garment of Joan, mother of Richard Robyn, and the second best beast, a young steer, of Jakke-John the father of Michael. Michael and Richard are therefore ordered to appear before the official of the Archdeacon of Corwall: they confess to the non-delivery of the mortuaries and are pronounced excommunicated.)

Also, in the feast of Christmas then next following, the said Alan came to the said church with force and arms, to wit, clubs and knives, and the said Michael and Richard also, being excommunicated as aforesaid, and the said curate warned them out of the said church, so that he could celebrate the first mass, as the manner is this day to do; they would not [go], but kept themselves in the church all day until the hour of noon, through which the first mass and the second were not celebrated, and the parishioners went home without their divine service, and the parson lost his offerings that day; at which hour of noon, when the said excommunicates, seeing that all the parishioners had gone, went away, the said [parson] celebrated a mass, etc.; and the same day, the said Alan threatened to kill the said parson before all the said

parishioners, so that the said parson scarce escaped out of the church to his own house in the same town, and there he kept himself the whole day for fear of the said Alan.

Also, in the same manner the said Alan, Michael and Richard disturbed the parishioners at divine service by remaining in the church on the day of the Epiphany then next following, and on that day the said Alan would have chased the parson out of his chancel by the windows, saying to him, that he should not pass out by the body of the church because that belonged to the parishioners and not to him; wherefore the said parson was very glad to escape secretly while others of the parish treated with the said Alan.

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WHAT IS A BILLION DOLLARS?

IF YOU HAD SPENT one dollar every minute since the Birth of Christ (1940 years ago) you would have spent only one billion dollars. But—our national debt is already 49 times that much, or $49,000,000,000. [Editorial note: This was true in 1940. In 1951 the debt limit of $275,000,000,000 was being pressed.]

Anyone who has a real job, owns real property, or anything of value, such as cash balances, bonds, stocks, life insurance, or other sources of future income, particularly salaried incomes which are more or less fixed, should read this and heed this warning.

In fact, it should provoke thought on the part of anyone who is making *present sacrifices* in the hope of *future income.*

The tremendous sum of 49 billion dollars is so huge that it cannot be measured even by the imagination, unless it is reduced to terms which everyone can understand, such as the fact that a $10.00 bill buys two pairs of pretty good shoes (at present). $49 billions of dollars in

$10.00 bills "laid end to end" would make a train 473,000 miles long—more than 19 times around the earth at the equator. This is about twice as far as the distance from the earth to the moon, and means an expenditure of over $1.00 per minute for almost 100,000 years.

The equivalent of all this money has got to be collected by a tax collector out of the income of people who are *producing,* and the end is not yet, since this large national debt has been incurred almost entirely before providing additional expenditure for necessary national defense.

It is as easy to say "billion" as it is to say "million," and everyone knows that a "billion" is something bigger than a "million," but few realize that it is *1000* times as hard to pay as a "million." Recently it has become almost as easy to secure public appropriations of "billions" as it used to be to secure "millions."

Why is this?

I believe the answer is that under recent trends, we have been producing and distributing more and more "Government" and proportionately less of *real* things.

No, *real wealth* cannot be borrowed into existence and this fact applies even to the government of such a great country as the United States.

Our National Defense expense bill has hardly been heard from yet.

The bill is yet to come for defense items "on order."

Is this good management, or is it bad management on a big scale?

What is the answer?

It is simply that we must quit fostering vagarious economic theories and get back to bed-rock fundamentals.

We must stop being governed by vague economic theorists who never produced anything *real* through the private enterprise system, and who consequently have no intimate understanding of *that* process of producing.

We must realize that if we are to retain our boasted democratic political set-up, we must stick to and *encourage* production by *private initiative* and *private enterprise* for reasonable gain as a motive for making *risk investments* for employing labor in *real* jobs, or we will go state socialistic, or worse.

* * * *

To help you visualize $49,000,000,000.00: 49 billion dollars in bills of $10 denomination would take 49 stacks, each stack 5⅛ miles high or a total of 251 miles. Further than from Washington, D. C., to Pittsburgh.

Check the above figures for yourself. A ten-dollar bill is only .00325-

inch thick. It takes 100 million ten-dollar bills to make One Billion Dollars.

E. L. Wiegand
A registered Democrat

This statement is by a man who has made over 100 inventions. He is qualified to speak because he has started a business from scratch, building it up with the help of worthy associates, and which now employs 400 people.

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IS MONEY UNLIMITED?

FRED C. FOY

In a few months America will be 175 years old.

It grew from a nation of 17 states and 4 million people in 1790, when the first census was taken, to 48 states and 150 million today.

But its growth was not just in people. It grew in industry, in agriculture, in bank deposits, in automobiles, in homes, in education, in every conceivable measure of strength.

It grew as a great democracy in which the people did for themselves all of the things they could.

In no one of the first 140 peacetime years of this nation's existence did our federal government spend as much as 1 billion dollars to meet the needs of its people, nor did the federal government collect as much as 1/3 of the total taxes.

Last year the federal government spent 40.2 billion dollars and grabbed over 70 cents out of every dollar of taxes paid anywhere in America.

During this same first 140 years the government was almost always in the black. It rarely spent more than it took in. It followed a national habit of buying only what it could pay for and paying for what it bought. And in peace years it paid off some of what it had borrowed in war years.

Then in 1929 the stock market crashed. This was followed by a severe business depression. And with it came a new kind of government thinking—the idea that the government should go into debt and spend more than it earned so as to make jobs for its people and work for its factories.

By 1937 business had picked up again. Men who wanted to work could find jobs. We were out of the depression, but the government was not out of the red. And it's never been out since, except by accident.

During 19 out of the last 21 years it has spent more than it has taken in. Its debt has risen from 16.2 billion dollars in 1930 to 257.4 billion dollars today. And don't let anyone tell you all this debt has been on account of war and its costs. Eighty-seven and four tenths billion dollars of that debt had nothing to do with war. It's just been plain fiscal self-indulgence—spending more than we took in.

Let's look at the 5 years since the war—5 years when we should have been recharging our financial batteries.

During these 5 years the federal government took in 201 billion dollars in taxes. This is more than it took in in the whole history of America before World War II.

When Japan surrendered, our national debt was 258 billion dollars. As of August 31 last year we still owed 257 billion dollars.

In other words, during 5 years when our government took from you and me 7 times as much in taxes as in the 5 years just before the war, it spent almost every penny of it.

During this whole period the government seems to have operated on the theory that it had a bottomless bank account. Don't think that I'm kidding.

* * * *

I wonder whether all of this free spending has really been good for all of us—whether it has been good for us to go into debt for nonwar luxuries, foregoing major debt reduction—and now, whether we can carry the burden of these luxuries during our current fight for survival.

* * * *

For the past 30 years America has grown because of salesmanship—homes, radios, refrigerators, cars, travel, clothes. You name it. Every

American, rich or poor, has been subjected not once but hundreds of times to salesmanship.

Mr. and Mrs. America have been convinced that they wanted things they didn't have and didn't think they could afford. And shown how to pay for them. And they bought them. Billions of dollars worth.

So what happened? Over the last 30 years our people have learned to love a good salesman!

And for the past 20 years they have been exposed to one of the largest and best-organized sales organizations the world has ever seen. It has its headquarters in Washington. It consists of 1,800 departments, bureaus, and assorted organizations. It has 2 million employees. And behind that a widespread political force.

Nor has it been a stranger to publicity and promotion. *Forbes Magazine* recently dug into this part of the federal government's daily doings.

It says the federal government spent over 100 million dollars on publicity and propaganda last year. The monthly figures looked like this:

$1,500,000 in salaries for publicity and public relations men.
$4,000,000 for cost of printing releases.
$3,500,000 for mailing.

A monthly budget of 9 million.

The Agriculture Department alone had over 600 persons engaged in publicity and promotion work alone in 1950. A House of Representatives Investigating Committee found the Agriculture Department in 9 months produced:

1,998 press releases
837 radio scripts
17 motion pictures
and 120,000 weekly clip sheets.

This same committee found 5 separate government agencies illegally using public funds to support the government's drive for socialized medicine. These were the U. S. Public Health Service, The Children's Bureau of The Department of Labor, The Office of Education, The Department of Agriculture, and The Social Security Administration.

In one form or another since 1932 this vast government sales organization has been telling our people of the things they needed, telling them that if they would just sign on the dotted ballot these things would be delivered promptly—and for free!

And so they bought. Why not? For free was even better than on

time. But we didn't get them for free. We paid for them. Last year alone we paid 10 billion 606 million dollars for things that had absolutely nothing to do with war or defense or veterans or debt or past wars, directly or indirectly.

State and local governments are catching on to the fact that the American people seem to like these free visits to The Public Lunch Counter. In 1945 state and local governments collected 10 billion dollars in taxes. By last year they were up to nearly 18 billion dollars.

Between them all, taxes in 1950 took 26.6 per cent of our whole national income. Of course, this thing the economists call "national income" is sort of vague to you and me and we really don't care how much of it the tax collector gets. Or do we?

I wonder how many of us really know what it is costing each one of us every year.

* * * *

Make no mistake about it. These free goods really aren't free. They never have been and they never will be. There simply isn't any such thing as a free lunch.

If there isn't, then, what are you paying?

Of course, the biggest single federal tax is your personal income tax. Once a year you know how much this comes to. You used to get pretty worked up about it when you had to dig it up all in a lump at one time.

Now, since most people never get their hands on it at all, it really isn't so very painful.

So let's say you know how much you pay directly in income tax.

The federal government would be happy if you thought your income tax was all the taxes you pay.

But it isn't.

Actually, for most people, their income tax is only a small part of what they pay.

* * * *

These income taxes will cover less than half of the federal government's costs next year. And half of the 26 billion dollars they bring in comes from families making less than $100 a week.

Corporation taxes bring in another fourth.

The rest comes from any number of special taxes that are added on to things you pay for.

The folks at *Newsweek* magazine say that all of these taxes you never see cost you and me, and the head of every family in America,

another $700 a year in addition to our income tax. And this was last year before we started to try to pay for the war.

This $700 was the total of the taxes hidden in, or placed on, the thousands of things you and I buy every year. Remember, no matter what it is, there is not one single thing we buy, no rent we pay, no doctor or dentist bill, that some part of the price we pay doesn't end up at the tax collector's office.

For example, here are some of the things we all buy—and how much of the price of each goes to that man who gets the tax money?

Eight cents of a 21¢ quart of milk is for taxes; 5¢ of a 15¢ loaf of bread; 11¢ of a 19¢ pack of cigarettes; $3.00 of a $5.00 bottle of whiskey; $2.00 of a $6.00 telephone bill; $3,000 of a $10,000 house; $700 of a $2,100 automobile. I could go on and on, but it gets painful to both the mind and the pocketbook.

Every time you buy anything, from a nickel phone call to a new home, the tax collectors take a cut for their bottomless bank accounts.

And this total for the average man already is $700-$1,000 every year.

Where do we go from here?

I say "where" because there are only three ways the government can pay for our current war costs. One is by printing money—just plain ugly inflation. I haven't heard anyone in America seriously suggest such a course. I hope we can dismiss it as a possibility.

A second is by more and more borrowing. But when a government is already 257 billion dollars in debt, there is a question as to how much more it can find lenders for. Probably it will have to borrow some, but many men with much greater financial knowledge than I sincerely believe that our government today should conserve its credit as jealously as it is attempting to conserve its other resources.

The third course is by increased taxation. Although Congress has just passed a new tax bill which will raise at least 8 billion dollars more in 1951 than in 1950, both the President and Congress already are talking another 20 billion dollars in taxes so as to put as much of the war costs as possible on a pay-as-you-go basis.

* * * *

Of course, when you've sold something it's hard to unsell it. When you've convinced the people they need things the government can give them, it's going to take real honesty, courage, and statesmanship, both in the Administration and in Congress, to tell the people that luxury spending is out for the duration.

So let's you and I, here and now, make up our minds that we want government to spend our money from this moment forward only for

things that are directly needed for our war effort, or to keep our nation operating on an essentials-only basis.

This goes for all government—local, state, federal—and it means stopping every dime of spending that is not really needed.

How much would it save?

Who knows?

Senator Byrd, who has long been a watchdog of federal spending, has written the President demanding that current federal spending be cut 7 billion 600 million dollars. And he says it can be done, if there is a will to do it.

The National City Bank of New York, which has studied the question, says at least 7 billion dollars could be cut.

Undoubtedly the states could make a real move back from that 18-billion-dollar figure towards that 10 billion dollars they used to spend.

But where would these cuts fall? Let's look at some areas. And I suppose that for each of these someone will say, "We can't cut that one, let's cut somewhere else." Probably that very feeling was why the money was spent in the first place. Some person or group had a special reason for thinking it ought to be spent.

Of course, stopping spending money, whether it be our own money or whether we're asking the government to stop, is never pleasant. What we are talking about here today is not whether we would like to do these things, but that we have to do them to save our very lives.

Perhaps the quickest way to give you some basis to think about it on is to begin with some boxcar figures in the budget just proposed.

The first administration measure of the new Congress is a 3-billion-dollar defense housing bill. This will be used to extend Federal Housing Administration mortgage guarantees. This program is one of the long-term commitments on the part of Uncle Sam. So long, in fact, that Federal Housing Chief, Raymond Foley, emphasized 2 billion dollars is already committed for carrying on the existing program; this leaves only 1 billion dollars that can be used for defense.

Do you think it is reasonable that there could be some cut in the "2 billion business-as-usual dollars" to help finance the 1 billion dollars for defense housing?

Senator Byrd said, "The President's budget represents the very height of fiscal irresponsibility," when he proposes to spend 9.8 billion for domestic-civilian purposes next year as compared with 8.4 billions this year.

Some of this 9.8 billion dollars is pin-pointed in a current legislative digest. Three hundred million dollars to "equalize education opportunities" among the states (as a defense measure, on the grounds that

the armed forces do not have time to teach draftees how to read and write).

Two hundred and seventy-five million dollars to set up the machinery for socialized medicine.

Another expansion of the public assistance and social security programs to a total of 2.6 billion dollars, an increase of 105 million dollars over this year. (During the last war this program cost the taxpayers just over 1 billion dollars a year.)

Seven new waterways projects costing 1.5 billion dollars as follows: Hell's Canyon, the Dalles and Ice Harbor Projects in the Columbia Basin; Old Hickory on the Cumberland; a steam plant for TVA; Gavins Point on the Missouri, and 20 million dollars to start the St. Lawrence Seaway. The President said the power output of these projects is necessary to the defense effort.

A 10-million-dollar increase in funds for supervising the sale of timber, building access roads and improving fish and wildlife services to provide additional lumber and food for the defense effort.

Of course, when we talk first about expenditures and savings in billions, and then we drop down to savings of 50 million or 100 million, there seems to be a tendency on the part of some in government, and even on the part of some in our Congress, to act as though we were talking about small change and that such minor savings are hardly worth making.

I, for one, have never been able to get my thinking adjusted to the point where 50 million dollars or 5 million dollars is small change.

A Council for State Chambers of Commerce voiced disapproval of expenditures advocated by the Administration for their benefit. They listed six major "Fair Deal" schemes urged in the name of defense:

1. Further nationalization of electric power.
2. Federal aid to education.
3. Extending federal subsidization and control of agriculture.
4. Imposing a system of socialized medicine.
5. Expansion of government-owned industrial production facilities.
6. Increasing the authority of the Department of Labor over state-administered unemployment compensation systems.

The Council found other threats to economy efforts in what it called the jockeying of many peacetime agencies to win national defense status, and the inclusion of small appropriations to initiate new spending projects "which are bound to snowball into annual expenditures of hundreds of millions of dollars as the new programs continue to grow."

* * * *

But to get back a minute to the boxcar figures, I didn't touch on agriculture at all. Agriculture has always been a large part of the government's total expenditures. But in the face of adequate prices for farm products, the administration proposes increasing expenditures from an estimated 986 million this year to 1 billion 429 million next year. Most of this increase was in the form of loan investment programs to aid agriculture, which for my money is just another way of saying that the government is trying to take money away from all of the people to turn around and give part of it to a special group of the people.

Groups must disappear—instead of this group and that group serving its own interests, they must resolve into one group giving all they can for one purpose and everyone's interest.

* * * *

In the first place, every government in America—state, local, federal—is our government, yours and mine and every other American's. It works for us. It's supposed to serve us. And everything it does is done with our money. If enough of us tell it to stop spending our money for things we don't need, either to win the war, or to stay strong while we're doing it, that's what will happen.

But all of us have to speak our minds. Don't forget the people who still have something they want to get from government—for free, and at what they hope will be the other fellow's expense.

There are two main ways we can do this. One is to vote for men who are pledged to see that what the government does makes sense and is truly necessary. The second is to back these men up when they try to do it. Let's see how we're doing on each of these counts. We have to use some more figures to do part of it.

In America there are somewhat over 93 million people old enough to vote. Yet there are less than 67 million who are registered. Think of it! Over 25 million people who haven't even taken out their free share of stock in America. And in the last Presidential election only about 49 million people actually voted. Think of it again! Just a little over half of the people who own America, who are America, had enough interest in America to vote for their President and Board of Directors.

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WAR ASSETS

FRED OTHMAN

FOR MONTHS I'd heard nothing about that wondrous foot-in-mouth organization, the War Assets Administration.

I figured it had been buried, as decently as possible, as per the instructions of Congress last year. But, no!

Here was the House of Representatives (February 2, 1949) worrying about a bill to extend the life of this mighty merchandising organization at least until next June. And as the gentlemen argued about the merits of this idea, I got to thinking about WAC pajama tops, opium peddling, explosive nuts and bolts, horse-drawn hearses, Civil War ramrods, and other subjects not so dear to the dear old, bumbling WAA.

This was the bureau organized soon after V-J Day to peddle about $25 billion worth of surplus war goods. Soon it had 49,000 employees, who spent a good part of their time countermanding each other's orders, trapping themselves in their own red tape, and testifying bitterly before an assortment of congressional investigators.

Every month, seemed like, a new administrator took over to reorganize the reorganization his predecessor had started. And there (I remember) was the Senate War Investigating Committee, worrying about a large consignment of summer-weight pajamas for WACs. They were unsalable. The senators asked, why?

They weren't complete, the WAA man said. And what did he mean by that? The poor devil blushed. Said all he had for sale was a warehouse full of pajama tops. He couldn't find the pants. So far as I know, he never did find 'em.

Then there was the unexpected demand for surplus life rafts. The

boys were amazed at the rushing business they did in these, until the Federal Narcotic Bureau stopped it. The WAA said—honestly—that it had no idea each raft contained a cache of heroin.

A Philadelphia junkman bought a case of WAA nuts and bolts. He dropped 'em and nearly blew up the west end of town. The label was wrong. The box held blasting powder.

In Philadelphia also there was a three-story building jammed to the roof with khaki-colored girdles for lady soldiers. They'd been there four years and had lost their snap.

There was testimony about officials taking joy rides in surplus flying machines. One fortunate junkman bought a whole airport of B-19's, only to discover to his delight that each tank was full of aviation gasoline. He drained it out and sold it for $500,000.

In delving into its warehouses, which numbered into the thousands, the WAA discovered a load of musket-stuffers left over from the Civil War and a garage full of horse-drawn hearses (with polished brass hubs on the wheels) from the Spanish-American fracas.

An electric fan seemed to have chewed up the records in the Chicago office, where a number of surplus-purchasers never got bills because the WAA couldn't discover what they'd bought.

Even so the WAA got rid of most of its stock; all it has left today (February 15, 1949) is $2,300,000,000 worth, and most of that is real estate. And also, I must report in all justice that the latest administrator, Jess Larson, has chopped his staff down to size, proceeded in a businesslike manner to sell his materials, and has been in no trouble with Congress.

* * * *

[Editor's Note: Subsequently, Mr. Larsen became head of a General Service Administration—an office created upon the recommendation of the Hoover Commission. In March 1950, Mr. Larsen reported on a Federal warehouse in Denver containing enough fluorescent light tubes to last that agency for 93 years at the present rate of use, enough loose-leaf binders for 247 years, and enough ruled paper to keep the binders filled for 168 years. He indicated that this situation might not be exceptional and might be duplicated if an examination were made of the hundreds of government warehouses scattered over the country.]

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THE 1952 FEDERAL BUDGET

The 1952 federal budget is a staggering document. Calling for expenditures of \$71½ billion in the fiscal year beginning July 1, it will mean, if the President's recommendations are approved by Congress, a spending total exceeded only in the three peak years of World War II —1943-45.

While the President estimated actual expenditures in fiscal '52 at \$71½ billion, he asked Congress for still larger sums in the form of authorizations for entering into new spending commitments during the year. This new obligational authority, including appropriations and loan and contract authorizations, footed up to \$94.4 billion, part of which will be spent in 1952 and the balance in subsequent years. In addition, the President asked for \$4.1 billion in appropriations to liquidate prior-year contract authorizations. Thus the grand total new spending authority requested comes to \$98½ billion.

As against these vast spending totals, the President estimated 1952 receipts from present tax rates at approximately \$55 billion. Large as this is, it still indicates a deficit—compared with actual expenditures—of 16½ billion. To avert this deficit, the President sees no room for cutting expenditures, but proposes only raising taxes.

Already, as shown in the table following, the presently expected yield of taxes for '52 far exceeds the total of any previous year. Yet the President proposes to pile on another \$16½ billion to balance the budget at \$71½ billion—and to ask for more money if expenditures go higher. According to figures given in the budget message, the program announcer will mean raising the federal tax load to 26 per cent of the national income; and adding in some \$16 billion of state and local taxes will bring the ratio to around 30 per cent. While this is well below the peak figures reached during the past war, the

UNITED STATES GOVERNMENT BUDGET RECEIPTS, EXPENDITURES, AND PUBLIC DEBT, 1914–1952
(In Millions of Dollars)

Year Ended June 30	*Total Net Receipts*	*Total Net Expenditures*	*Net Surplus or Deficit*	*Public Debt, June 30*
1914	$ 735	$ 735	$ 0	$ 1,188
1915	698	761	— 63	1,191
1916	783	734	+ 48	1,225
1917	1,124	1,978	— 853	2,976
1918	3,665	12,697	— 9,032	12,244
1919	5,152	18,515	—13,363	25,482
1920	6,995	6,403	+ 291	24,299
1921	5,625	5,116	+ 509	23,977
1922	4,109	3,373	+ 736	22,963
1923	4,007	3,295	+ 713	22,350
1924	4,012	3,049	+ 963	21,251
1925	3,780	3,063	+ 717	20,516
1926	3,963	3,098	+ 865	19,643
1927	4,129	2,974	+ 1,155	18,512
1928	4,042	3,103	+ 939	17,604
1929	4,033	3,299	+ 734	16,931
1930	4,178	3,440	+ 738	16,185
1931	3,190	3,652	— 462	16,801
1932	2,006	4,741	— 2,735	19,487
1933	2,080	4,681	— 2,602	22,539
1934	3,116	6,745	— 3,630	27,053
1935	3,800	6,592	— 2,791	28,701
1936	4,116	8,541	— 4,425	33,779
1937	5,029	8,706	— 2,777	36,425
1938	5,855	7,031	— 1,177	37,165
1939	5,103	8,966	— 3,862	40,440
1940	5,296	9,206	— 3,910	42,968
1941	7,227	13,387	— 6,159	48,961
1942	12,696	34,187	—21,490	72,422
1943	22,201	79,622	—57,420	136,696
1944	43,892	95,315	—51,423	201,003
1945	44,762	98,703	—53,941	258,682
1946	40,027	60,703	—20,676	269,422
1947	40,043	39,289	+ 754	258,286
1948	42,211	33,791	+ 8,419	252,292
1949	38,246	40,057	— 1,811	252,770
1950	37,045	40,156	— 3,111	257,357
1951 Est.	44,512	47,210	— 2,698	260,300
1952 Est.*	55,138	71,594	—16,456	276,300

* Excluding proposed new taxes.

latter ruled for only a brief period and were not, as at present, at the beginning of a period of partial mobilization that may last for years.

Though the public had been prepared for a large increase in budget totals, the figures announced by the President came as a shock. Not only is the projected rise in military spending greater than had been generally anticipated, but the public had looked for a much more determined effort to cut non-defense spending.

To the extent that the rise in national defense spending reflects genuine progress in increasing the effectiveness of the armed forces, it is of course all to the good. The failure, on the other hand, to accomplish significant results in reducing non-defense costs is a grave disappointment and calls for searching inquiry by both Congress and the public.

Any attempt, however, to gauge the real trend of defense as against non-defense spending must recognize the danger of placing too much reliance on budget labels. Not only are many projects related to defense carried under other headings—for example, atomic energy is included under "natural resources," and the government program for defense plant expansion appears under "finance, commerce, and industry"—but there is a strong tendency for many peacetime projects which are threatened with budget cuts to get wrapped in the protective mantle of "defense."

The next table gives the President's own figures as to major defense and non-defense outlays, based on a reclassification of budget items and given out as a special news release in connection with the budget message. It segregates "major national security programs" from other expenditures, and includes also "major fixed and continuing charges," the latter explained as including items not subject to annual budgetary control, such as interest on the public debt, as well as other programs governed largely by existing legislation but still subject in varying degree to administrative action.

As the table shows, out of total proposed spending in fiscal '52 of \$71,594 million the President puts cost of "major national security programs" at \$52,510 million. This leaves spending for all other government purposes at \$19,084 million, down only \$1,082 million from estimated expenditures for corresponding purposes in fiscal '51. Measured against the kind of stern retrenchment the situation calls for, this is hardly more than a beginning.

The President goes on to deduct "major fixed and continuing charges" amounting in '52 to \$13,948 million, thus reducing the budget total—excluding "major national security, fixed and continuing charges"—to \$5,136 million. Even this comparatively small residual total, he contends, contains defense el-

ANALYSIS OF BUDGET EXPENDITURES FOR FISCAL YEARS 1951 AND 1952
(In Millions of Dollars)

	1951	1952
Budget Totals	$47,210	$71,594
Deduct:		
Major national security programs:		
Military services	20,994	41,421
International security	4,726	7,461
Atomic Energy Commission	818	1,277
Defense production and controls	296	1,403
Civil defense	15	330
Maritime activities	189	354
Defense housing and community facilities	.....	100
Dispersal program	6	164
Total major national security programs	27,044	52,510
Remainder	20,166	19,084
Deduct:		
Major fixed and continuing charges:		
Veterans services and benefits	5,746	4,911
Interest	5,722	5,897
Permanent and indefinite appropriations	1,485	1,366
Reconstruction Finance Corporation	—84	—42
Federal National Mortgage Association	189	—530
Commodity Credit Corporation	—150	252
Home Loan Bank Board	—92	—14
Public assistance grants	1,281	1,300
Public roads	469	473
International wheat agreement	....	77
Foot-and-Mouth disease control	2	33
Payment of claims and reserve for contingencies	141	225
Total, major fixed and continuing charges	14,709	13,948
Budget totals, excluding major national security, fixed and continuing charges	5,457	5,136

All of which seems calculated to give the impression that there is little more that can be done to cut the budget.

Actually, it will be hard to convince the American people, who are asked to make sacrifices in their own daily lives, that the meagre economies revealed by the President are all that can be squeezed out of the huge $71½ billion spending total. There is not a single major classification of the budget that does not call for critical analysis.

In fairness to the Administration, it should be noted that some real effort appears to have been made to cut expenditures for some non-war activities. The financing of rural electrification and rural telephones is reduced from $312 million in '51 to $269 million in '52, and the Corps of Engineers and Reclamation projects are down from the record-breaking $1,011 million this year to $873 million next year.

Expenditures for veterans' services and benefits are decreased $835 million, due mainly to reduced enrollments for education and training. The change in the Federal National Mortgage Association from a net outlay to a net receipt of over $500 million reflects the accelerated sales of home mortgages by that agency in keeping with the new policy of tightening up on mortgage credit.

The trouble is that these and other economies are too little and too few. The budget continues to provide hundreds of millions of dollars for such paternalistic programs as federal aid to education ($300 million), school lunches ($83 million), farm housing, rural electrification, federal power, and many other things. In addition, the budget proposes small beginning outlays for new spending projects destined to mushroom as time goes on, notably compulsory health insurance, and the initiation of seven new public power projects to cost eventually $1.5 billion. While commencement of the latter is requested as part of the defense effort, the question arises as to how much of this expansion of electrical capacity could be done with private capital if given proper encouragement. The question is pertinent in view of the discouraging effect of public power encroachment on plans of private utilities in many areas, and the known instances where a government department has actually sought to block power developments by private utility companies because the department itself wanted to develop them with public money.

All in all, the impression gained from examination of the 1,032 pages of this massive budget is that, despite the dictum laid down in the State of the Union message that the Government "must practice rigid economy in its non-defense activities," actually it is an austerity budget for the taxpayer only.

It is encouraging that Congressional leaders of both parties have expressed their concern over these vast spending proposals. Chairman Robert L. Doughton, of the House Ways and Means Committee, is reported to have served notice on the Administration that he and his committee want non-defense spending cut before they approve new taxes. The studies by Senator Byrd and others have demonstrated that some $6 to $9 billion of "fat" can be cut out of the budget, if only there is the courage and determination to do it.

Experience has shown, however, that budget-cutting is a tough and discouraging assignment. It can be done, but it will need all the support that can be marshalled from the folks "back home." After all, the pressure for spending comes from outside as well as inside the Government. People have got to realize that they can't cry for economy in Government with one breath, and clamor in the next for that new dam or new post office or new veterans' hospital for their community.

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OUR NATIONAL DEBT AFTER GREAT WARS

Five times in our history, war expenditures built up huge public debts. Each time many thoughtful people believed that the debts were so big that we never could pay them or even greatly reduce them. This did not prove true in the four wars prior to the past one, and a review of our previous war debts may show what lessons from earlier experiences may be useful now.

INFLATION AND DEFLATION

One outstanding economic fact is that each great war produced serious inflation of commodity prices. Each time, the cost of living soared. The experience was painful; still more painful was the deflation which always followed and brought distress to farmers and unemployment to wage-earners.

The facts of war-caused inflations and deflations were recognized by John Adams, second President of the United States, who wrote: "I am old enough to remember the war of 1745 and its end, the war of 1755 and its close, the war of 1775 and its termination, the war of 1812 and its pacification. Every one of these wars has been followed by

general distress, embarrassments of commerce, destruction of manufactures, and a fall in the prices of produce and of lands."

. . . It is striking that the Revolution, the War of 1812, the Civil War and World War I produced such huge increases of commodity prices in a brief few months, and such long-drawn-out decreases with dire economic toll. Will prices in this era follow the same pattern, down as well as up? By the middle of 1948 the price level reached the peaks of previous great wars. Many believed that artificial government control of prices would have saved us from the inflation which followed other wars. Whether or not it could have done so, most controls were suspended in the autumn of 1946.

In the War of 1812 and the Civil War, prices broke almost immediately when the fighting stopped. But after World War I, prices rose for eighteen months after the armistice. More than three years after the end of World War II, prices were still high, though there were indications that the end of the rise might already have occurred.

It is worth noting that the depression following the War of 1812 forced wholesale prices far below those when war inflation got under way. This was partly because even before we went to war, the country was affected by price increases of the Napoleonic wars. After the Civil War, a fairly continuous deflation carried prices down to levels almost identical with those when inflation began. In the 1880's and 1890's prices fell still lower, but the Civil War's deflation probably should be considered ended when gold payments were resumed in 1879. World War I inflation began in 1914 with prices at 99 (in terms of an average 1910-1914 equals 100 per cent) and carried them to 226, but the subsequent two-stage deflation brought 1932 prices virtually back to the 1914 level. Despite the similarity of some of these movements, we should look into causes and not assume that the statistical pattern will be repeated. Nevertheless, it is interesting that wholesale prices during and after World War II rose in much the same manner as in World War I.

INFLATION AND THE DEBT

One of the few economic findings about which there is fairly widespread agreement is that wartime price inflations are caused by governments having to spend more than they can raise in taxes. They either print or borrow the money and pour into the hands of the people more than they have normal ways of spending. There is also a scarcity of goods—and thus the now-familiar spectacle of lavish spending from swollen pocketbooks.

In the theory, excessive price rises could be avoided by taxing the people so heavily that the Government could regain all the extra money it paid in war wages and contracts. No government has ever found how to do this. One reason is that the new money is unevenly distributed, and heavy taxes might fall on people who have received none of it. Another reason is that taxes must be voted by politicians likely to lose their jobs if tax policies are too bold.

In our country's early wars, there was no adequate or elastic tax machinery. In the Revolution, the central government had no taxing power whatever and levied on the states with pathetically poor results. Toward the end of the war, for example, Robert Morris persuaded Alexander Hamilton to become a tax collector in New York in the hope that with his great and rising influence he might persuade New York State to raise and pay to the government her assessment for the year 1782 of $365,000. In spite of his most vigorous efforts Hamilton collected only $6,250, and before many months resigned the position as hopeless. In this situation, with no banks from which to borrow and with France and Holland making only modest loans, the Continental Congress resorted perforce to the printing of paper money which eventually was "not worth a continental."

National government was more firmly established by the time of the War of 1812. But neither Congress nor the Treasury was ready with a financial policy adequate for the extraordinary demands of armed conflict. Three times—in 1807, in 1808, and again in 1810—Secretary of the Treasury Gallatin proposed that should war come, it should be financed by loans, and that taxes should be increased only to cover expenses of the peacetime establishment and interest on new loans and existing debts. He even declared that in no event would he insist on internal taxes. Thus developed the doctrine of war financing associated with his name, a doctrine which the historian Hildreth referred to in these caustic words: "Out of a tenderness for the people or a tender regard for their own popularity, Congress had resolved to carry on the war without imposition of taxes."

Fortunately, the increase in expenditures was relatively much less than during later wars. About 57 per cent of total costs of the War of 1812 were met by borrowing and about 43 from taxes and other receipts.

For financing the Civil War, Congress was extremely slow in increasing taxes. In the first year of the war 90 per cent of the expenditures were met by borrowing and 85 per cent in the second year. For the war as a whole, borrowing accounted for 77 per cent of the expenditures, and 23 per cent came from taxes and sale of land.

This country entered World War I with two new features in its tax structure which enormously aided war financing. One was the income tax on individuals and corporations. The other was the excess profits tax on corporations. These were made legal in 1913 by the Sixteenth Amendment to the Constitution. Despite these new features, taxation met only 28 per cent of the war's expenditures; borrowing was 72 per cent. One reason was that World War I outlays were ten times those of the Civil War.

World War II's expenditures were ten times those of World War I, yet 46 per cent of the needed funds came from taxation, 54 per cent from borrowing. This record was achieved by vigorous use of income and excise taxes.

The discouraging part of the picture is that even with drastic application of a modernized tax system, more than half our costs were still raised by borrowing—by the very method which has proved to be inflationary. This raises the uncomfortable question whether our spending was unnecessarily lavish. Of course, penuriousness never won a war, and Americans do not resent the huge outlay for the atomic bomb, but we pay the cost in rising living expenses and later deflations. We need to be alert in time of war, and especially at the end of each war, to limit unneeded and costly bureaus and functions.

THE CHANGING PER CAPITA DEBT

In 1790, when Alexander Hamilton, then 33 and the first Secretary of the Treasury, had been in office only a few months, he estimated the new nation's public debt at about 72.4 million dollars. The foreign debt which was owed mostly in France and Holland was 11.7 millions. The domestic national debt was 42.4 millions of which one-third was arrears of interest. And debt to the states for services and supplies amounted to 18.3 millions.

These sums seem small today but were embarrassingly large then. To the young nation, short of capital and impoverished by war and inflation, 72.4 millions in hard money was enormous. The debt had to be borne by a population of only 3.9 millions, mostly poor farmers, traders and frontiersmen. Moreover, when Hamilton entered the Treasury, confidence in the Government's ability to pay was so low that certificates of public indebtedness sold at 10 and 20 cents on the dollar.

* * * *

In 1790, the debt could have been wiped out if each inhabitant of

the United States paid in $19 to the national Treasury. After the War of 1812, each person would have had to pay $15. After the Civil War, the figure rose to $78; and after World War I it was $240. In 1948, after the debt had been reduced somewhat, each one of us would have had to pay about $1,720 to extinguish the debt—this over and above tax collections each year to keep the Government running.

PART ELEVEN

Comparative Economic Systems

CURRENT EVENTS HAVE REVIVED an interest in the "isms," which, for a number of years, had largely dropped out of public discussion. Today, the inclusion of portions of the *Communist Manifesto* (149) in a list of readings seems appropriate. Likewise, Selection 150 suggests that even an American socialist, back in 1907, saw merits in revolution—although Eugene V. Debs, the author of the selection, probably mellowed with the years. Selection 151 is a lesson in socialism in a lighter vein and, if analyzed critically, leads to some interesting conclusions. The Soviet financial system is discussed by A. Baykov and G. R. Barker (152). Number 153 is Ludwig von Mises' statement on fascism—a movement which, although "officially" defeated, is not destroyed. Number 154 is a review of the nature of our economic system by R. E. Slesinger. Number 155 is a statement of the nature of free society by H. W. Metz and Charles A. H. Thomson. Selection 156 is a full evaluation of the American economy by Sumner H. Slichter. Selection 157 contains William I. Nichols' idea that a new word for "capitalism" might clear the atmosphere of the connotations heaped upon that term by history and by communist sympathizers—an idea which elicited hundreds of suggestions for a new term, some of which are printed in this reading.

Other selections which might be read in connection with this Part are 126 and 127.

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(153) von Mises, Ludwig, *Planned Chaos,* Irvington-on-Hudson, New York: Foundation for Economic Education, 1947, pp. 70–74.

(154) Slesinger, R. E., *The Smaller Manufacturer,* Pittsburgh: The Smaller Manufacturers' Council, January 1950.

(155) Metz, H. W. and C. A. H. Thomson, *Authoritarianism and the Individual,* The Brookings Institution, 1950, pp. 1–8.

(156) Slichter, Sumner, *The American Economy,* Knopf, 1948, pp. 186–214.

(157) Nichols, W. I., "Wanted: A New Name for Capitalism," *This Week,* March 4, 1951.

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THE COMMUNIST MANIFESTO, 1847

KARL MARX and FRIEDRICH ENGELS

I. Bourgeois and Proletarians:

The history of all hitherto existing society is the history of class struggles.

Freeman and slave, patrician and plebeian, lord and serf, guild-master and journeyman, in a word, oppressor and oppressed, stood in constant opposition to one another, carried on an uninterrupted, now open fight, a fight that each time ended either in a revolutionary reconstitution of society at large, or in the common ruin of the contending classes.

* * * *

The modern bourgeois society that has sprouted from the ruins of feudal society, has not done away with class antagonisms. It has but established new classes, new conditions of oppression, new forms of struggle in place of the old ones.

Our epoch, the epoch of the bourgeoisie, possesses, however, this distinctive feature: It has simplified the class antagonisms. Society as a whole is more and more splitting up into two great hostile camps, into two great classes directly facing each other—bourgeoisie and proletariat.

* * * *

Modern industry has established the world market, for which the discovery of America paved the way. This market has given an immense development to commerce, to navigation, to communication by land. This development has, in its turn, reacted on the extension of industry; and in proportion as industry, commerce, navigation, rail-

ways extended, in the same proportion the bourgeoisie developed, increased its capital, and pushed into the background every class handed down from the Middle Ages.

* * * *

The bourgeoisie has stripped of its halo every occupation hitherto honoured and looked up to with reverent awe. It has converted the physician, the lawyer, the priest, the poet, the man of science, into its paid wage-labourers.

The bourgeoisie has torn away from the family its sentimental veil, and has reduced the family relation to a mere money relation.

* * * *

The bourgeoisie, by the rapid improvement of all instruments of production, by the immensely facilitated means of communications, draws all nations, even the most barbarian, into civilisation. The cheap prices of its commodities are the heavy artillery with which it batters down all Chinese walls, with which it forces the barbarians' intensely obstinate hatred of foreigners to capitulate. It compels all nations, on pain of extinction, to adopt the bourgeois mode of production; it compels them to introduce what it calls civilization into their midst, i.e., to become bourgeois themselves. In a word, it creates a world after its own image.

* * * *

The weapons with which the bourgeoisie felled feudalism to the ground are now turned against the bourgeoisie itself.

But not only has the bourgeoisie forged the weapons that bring death to itself; it has also called into existence the men who are to wield those weapons—the modern working class—the proletarians.

* * * *

Owing to the extensive use of machinery and to division of labour, the work of the proletarians has lost all individual character, and consequently, all charm for the workman. He becomes an appendage of the machine, and it is only the most simple, most monotonous, and most easily acquired knack, that is required of him.

* * * *

Modern industry has converted the little workshop of the patriarchal master into the great factory of the industrial capitalist. Masses of labourers, crowded into the factory, are organised like soldiers. As pri-

vates of the industrial army they are placed under the command of a perfect hierarchy of officers and sergeants. Not only are they slaves of the bourgeois class, and of the bourgeois state; they are daily and hourly enslaved by the machine, by the over-looker, and, above all, by the individual bourgeois manufacturer himself. The more openly this despotism proclaims gain to be its end and aim, the more petty, the more hateful and the more embittering it is.

* * * *

Finally, in times when the class struggle nears the decisive hour, the process of dissolution going on within the the ruling class, in fact within the whole range of old society, assumes such a violent, glaring character, that a small section of the ruling class cuts itself adrift, and joins the revolutionary class, the class that holds the future in its hands. Just as, therefore, at an earlier period, a section of the nobility went over to the bourgeoisie, so now a portion of the bourgeoisie goes over to the proletariat, and in particular, a portion of the bourgeois ideologists, who have raised themselves to the level of comprehending theoretically the historical movement as a whole.

Of all the classes that stand face to face with the bourgeoisie today, the proletariat alone is a really revolutionary class. The other classes decay and finally disappear in the face of modern industry; the proletariat is its special and essential product.

* * * *

The social conditions of the old society no longer exist for the proletariat. . . . Law, morality, religion, are to him so many bourgeois prejudices, behind which lurk in ambush just as many bourgeois interests.

* * * *

The development of modern industry . . . cuts from under its feet the very foundation on which the bourgeoisie produces and appropriates products. What the bourgeoisie therefore produces, above all, are its own grave-diggers. Its fall and the victory of the proletariat are equally inevitable.

* * * *

The immediate aim of the communists is the same as that of all the other proletarian parties: formation of the proletariat into a class, overthrow of bourgeois supremacy, conquest of political power by the proletariat.

The theoretical conclusions of the communists are in no way based on ideas or principles that have been invented, or discovered, by this or that would-be universal reformer.

* * * *

The distinguishing feature of communism is not the abolition of property generally, but the abolition of bourgeois property. But modern bourgeois private property is the final and most complete expression of the system of producing and appropriating products that is based on class antagonisms, on the exploitation of the many by the few.

In this sense, the theory of the communists may be summed up in the single sentence: Abolition of private property.

* * * *

You are horrified at our intending to do away with private property. But in your existing society, private property is already done away with for nine-tenths of the population; its existence for the few is solely due to its non-existence in the hands of those nine-tenths. You reproach us, therefore, with intending to do away with a form of property, the necessary condition for whose existence is the non-existence of any property for the immense majority of society.

In a word, you reproach us with intending to do away with your property. Precisely so; that is just what we intend.

* * * *

Abolition of the family! Even the most radical flare up at this infamous proposal of the communists.

On what foundation is the present family, the bourgeois family based? On capital, on private gain. In its completely developed form this family exists only among the bourgeoisie. But this state of things finds its complement in the practical absence of the family among the proletarians, and in public prostitution.

The bourgeois family will vanish as a matter of course when its complement vanishes, and both will vanish with the vanishing of capital.

Do you charge us with wanting to stop the exploitation of the children by their parents? To this crime we plead guilty.

The bourgeois claptrap about the family and education, about the hallowed co-relation of parent and child, becomes all the more disgusting, the more, by the action of modern industry, all family ties among the proletarians are torn asunder, and their children transformed into simple articles of commerce and instruments of labour.

But you communists would introduce community of women, screams the whole bourgeoisie in chorus.

The bourgeois sees in his wife a mere instrument of production. He hears that the instruments of production are to be exploited in common, and, naturally, can come to no other conclusion than that the lot of being common to all will likewise fall to the women.

He has not even a suspicion that the real point aimed at is to do away with the status of women as mere instruments of production.

For the rest, nothing is more ridiculous than the virtuous indignation of our bourgeois at the community of women which, they pretend, is to be openly and officially established by the communists. The communists have no need to introduce community of women; it has existed almost from time immemorial.

Our bourgeois, not content with having the wives and daughters of their proletarians at their disposal, not to speak of common prostitutes, take the greatest pleasure in seducing each other's wives.

Bourgeois marriage is in reality a system of wives in common and thus, at the most, what the communists might possibly be reproached with is that they desire to introduce, in substitution for a hypocritically concealed, an openly legalised community of women. For the rest, it is self-evident, that the abolition of the present system of production must bring with it the abolition of the community of women springing from that system, i.e., of prostitution both public and private.

The communists are further reproached with desiring to abolish countries and nationality.

The workingmen have no country. We cannot take from them what they have not got. Since the proletariat must first of all acquire political supremacy, must constitute itself *the* nation, it is, so far, itself national, though not in the bourgeois sense of the word.

National differences and antagonisms between peoples are vanishing gradually from day to day. . . . The supremacy of the proletariat will cause them to vanish still faster.

* * * *

The proletariat will use its political supremacy to wrest, by degrees, all capital from the bourgeoisie, to centralise all instruments of production in the hands of the state, i.e., of the proletariat organised as the ruling class; and to increase the total of productive forces as rapidly as possible.

Of course, in the beginning, this cannot be effected except by means of despotic inroads on the rights of property, and on the conditions of bourgeois production; by means of measures, therefore, which appear

economically insufficient and untenable, but which, in the course of the movement, outstrip themselves, necessitate further inroads upon the old social order, and are unavoidable as a means of entirely revolutionising the mode of production.

These measures will of course be different in different countries.

Nevertheless in the most advanced countries, the following will be pretty generally applicable.

1. Abolition of property in land and application of all rents of land to public purposes.
2. A heavy progressive or graduated income tax.
3. Abolition of all right of inheritance.
4. Confiscation of the property of all emigrants and rebels.
5. Centralisation of credit in the hands of the state, by means of a national bank with state capital and an exclusive monopoly.
6. Centralisation of the means of communication and transport in the hands of the state.
7. Extension of factories and instruments of production owned by the state; the bringing into cultivation of waste lands, and the improvement of the soil generally in accordance with a common plan.
8. Equal obligation of all to work. Establishment of industrial armies, especially for agriculture.
9. Combination of agriculture with manufacturing industries; gradual abolition of the distinction between town and country, by a more equable distribution of the population over the country.
10. Free education for all children in public schools. Abolition of child factory labour in its present form. Combination of education with industrial production, etc.

When, in the course of development, class distinctions have disappeared, and all production has been concentrated in the hands of a vast association of the whole nation, the public power will lose its political character. Political power, properly so called, is merely the organized power of one class for oppressing another. If the proletariat during its contest with the bourgeoisie is compelled, by the force of circumstances, to organise itself as a class; if, by means of a revolution, it makes itself the ruling class, and, as such, sweeps away by force the old conditions of production, then it will, along with these conditions, have swept away the conditions for the existence of class antagonisms, and of classes generally, and will thereby have abolished its own supremacy as a class.

In place of the old bourgeois society, with its classes and class antagonisms, we shall have an association in which the free development of each is the condition for the free development of all.

* * * *

In short, the communists everywhere support every revolutionary movement against the existing social and political order of things.

* * * *

The communists disdain to conceal their views and aims. They openly declare that their ends can be attained only by the forcible overthrow of all existing social conditions. Let the ruling classes tremble at a communist revolution. The proletarians have nothing to lose but their chains. They have a world to win.

Workingmen of all countries, unite!

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REVOLUTION

EUGENE V. DEBS

THIS IS THE FIRST AND ONLY International Labor Day [1907]. It belongs to the working class and is dedicated to the Revolution.

Today the slaves of all the world are taking a fresh breath in the long and weary march; pausing a moment to clear their lungs and shout for joy; celebrating in festal fellowship their coming Freedom.

> All hail the Labor Day of May!
> The day of the proletarian protest;
> The day of stern resolve;
> The day of noble aspiration.
> Raise high this day the blood-red Standard of the Revolution!
> The banner of the Workingmen;
> The flag, the only flag, of Freedom.

Slavery, even the most abject—dumb and despairing as it may seem—has yet its inspiration. Crushed it may be, but extinguished never.

Chain the slave as you will, O Masters, brutalize him as you may, yet in his soul, though dead, he yearns for freedom still.

The great discovery the modern slaves have made is that they themselves their freedom must achieve. This is the secret of their solidarity; the heart of their hope; the inspiration that nerves them all with sinews of steel.

> They are still in bondage, but no longer cower;
> No longer grovel in the dust,
> But stand erect like men.
>
> Conscious of their growing power the future holds out to them her outstretched hands.
>
> As the slavery of the working class is international, so the movement for its emancipation.
>
> The salutation of slave to slave this day is repeated in every human tongue as it goes ringing round the world.
>
> The many millions are at last awakening. For countless ages they have suffered; drained to the dregs the bitter cup of misery and woe.
>
> At last, at last the historic limitation has been reached, and soon a new sun will light the world.
>
> Red is the life-tide of our common humanity and red our symbol of universal kinship.
>
> Tyrants deny it; fear it; tremble with rage and terror when they behold it.
>
> We reaffirm it and on this day pledge anew our fidelity—come life or death—to the blood-red Banner of the Revolution.
>
> Socialist greetings this day to all our fellow-workers! To the god-like souls in Russia marching grimly, sublimely into the jaws of hell with the Song of the Revolution in their death-rattle; to the Orient, the Occident and all the Isles of the Sea!

VIVE LA REVOLUTION!

The most heroic word in all languages is REVOLUTION.

It thrills and vibrates; cheers and inspires. Tyrants and time-servers fear it, but the oppressed hail it with joy.

The throne trembles when this throbbing word is lisped, but to the hovel it is food for the famishing and hope for the victims of despair.

Let us glorify the revolutions of the past and hail the Great Revolution yet to come before Emancipation shall make all the days of the year May Days of peace and plenty for the sons and daughters of toil.

* * * *

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A LESSON IN SOCIALISM

THOMAS J. SHELLY

As A TEACHER in the public schools, I find that the socialist-communist idea of taking "from each according to his ability," and giving "to each according to his need" is now generally accepted without question by most of our pupils. In an effort to explain the fallacy in this theory, I sometimes try this approach with my pupils:

When one of the brighter or harder-working pupils makes a grade of 95 on a test, I suggest that I take away 20 points and give them to a student who has made only 55 points on his test. Thus each would contribute according to his ability and—since both would have a passing mark—each would receive according to his need. After I have juggled the grades of all the other pupils in this fashion, the result is usually a "common ownership" grade of between 75 and 80—the minimum needed for passing, or for survival. Then I speculate with the pupils as to the probable results if I actually used the socialistic theory for grading papers.

First, the highly productive pupils—and they are always a minority in school as well as in life—would soon lose all incentive for producing. Why strive to make a high grade if part of it is taken from you by "authority" and given to someone else?

Second, the less productive pupils—a majority in school as elsewhere—would, for a time, be relieved of the necessity to study or to produce. This socialist-communist system would continue until the high producers had sunk—or had been driven down—to the level of the low producers. At that point, in order for anyone to survive, the "authority" would have no alternative but to begin a system of compulsory labor and punishments against even the low producers. They, of course, would then complain bitterly, but without understanding.

Finally I return the discussion to the ideas of freedom and enterprise —the market economy—where each person has freedom of choice, and is responsible for his own decisions and welfare.

Gratifyingly enough, most of my pupils then understand what I mean when I explain that socialism—even in a democracy—will eventually result in a living-death for all except the "authorities" and a few of their favorite lackeys.

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THE SOVIET FINANCIAL SYSTEM

ALEXANDER BAYKOV and G. R. BARKER

In the Soviet planned economy the role of the financial system is subordinate to planned economic and cultural development. It is called upon only to assist in the fulfilment of these plans. At the same time, the State Budget and the credit system, so far as they control the economical use of material and financial resources, are so organised as to participate in the prosecution of the collective tasks set by economic plans.

In accordance with this role, the Soviet State Budget and the credit system are not only both more closely connected with the entire economic life of the nation than in other countries, but also actively assist in controlling the fulfilment of the tasks set by the economic plans.

The revenue of the State Budget is derived from two sources, and thus falls into two groups: (*a*) the main sources of revenue are: (1) the turnover tax, and (2) deductions from the profits of enterprises; in group (*b*): (1) subscriptions to State loans, and (2) taxes and levies on the population.

The turnover tax, apart from being the main source of revenue, also plays an important role in regulating prices and controlling the financial activities of enterprises. Only in its fiscal aspect can the turnover tax be compared with the British purchase tax. Turnover tax is calculated as a fixed percentage of the wholesale transfer price of producers' goods, or, in the case of most agricultural products, as a fixed monetary rate on the quantity of the product sold by wholesale trade. The rates vary from a nominal rate of 0.5 per cent. to rates of over 80 per cent.

Of revenue derived directly from the public, the most important form is subscription to State Loans. The income from these subscriptions is a prominent item in the revenue of the Soviet State Budget. State Loans absorb the savings of the public into the State Budget and are thence utilised as long-term credit for the development of the national economy. Since, in the Soviet Union, a market for shares and private investments capital does not exist, the mobilisation of the population's savings for long-term credits is organised through subscriptions to State Loans.

These Loans are subscribed either by collective and individual subscription on a deferred payments basis or by the sale of bonds for cash through the savings banks. State Loans are subscribed to by almost every wage- and salary-earner. In the pre-war period both the number of bond-holders and the total savings invested in State Loans considerably surpassed the number of depositors and the amount of savings accumulated in the Savings Banks, which are the only existing institutions where the current savings of the public may be deposited.

Apart from subscriptions to State Loans, certain Soviet institutions also invest their liquid assets reserved for special purposes in State bonds, such as the stable balance of deposits of savings banks, and the reserve capital of State insurance institutions, as well as the reserve capital of some other enterprises and institutions. Thus, by means of subscriptions to State Loans, nearly all the stable savings of the population and stable reserves of institutions are accumulated in the State Budget and thence allocated as grants or long-term credits to the national economy.

The Soviet system of taxes on the population also possesses some features different from the taxation-systems of other countries. The rural population pays taxes both in money and in kind—the latter by compulsory deliveries of definite amounts of agricultural products to the State at fixed prices below the market price of these products, which are afterwards sold to the population through the State trade

channels at a much higher price, and the difference, in the form of turnover tax, is accumulated in the revenue of the State budget.

Income tax and cultural and housing welfare contributions are not only based on the principle of progression but also vary according to the source of the tax payer's income, whether the tax payer be a worker or an employee, a professional man or a craftsman or artisan member (or non-member) of a co-operative association, or a person having an unearned income.

Income from wages and salaries earned in State and co-operative enterprises and institutions is taxed at privileged rates, whereas income derived from private activity—that of professional men, individual artisans and craftsmen non-members of productive co-operatives, and especially non-earned incomes—is taxed at a much higher rate. In this way taxation pursues not only fiscal, but also social and political aims.

The functions of the Soviet budget system in the prosecution of the annual national plans for the economic and cultural development of the country are much more important and diverse than those ordinarily performed by the State budgets of other countries.

The two main items of expenditure of Soviet State budgets, which figure far more prominently than in the budgets of other countries, are expenditures on financing the development of the national economy and expenditures on social and cultural measures. A third group consists of the usual expenditures of State budgets in all countries: that is, expenditures on defence and on State administration in the broad sense of the word.

Expenditure on financing the development of the national economy is centralised and consequently is effected, in the main, through the Union Budget, whereas social and cultural expenditure, in the main, is decentralised.

Expenditures on the development of all heavy and war industries, as well as on large-scale enterprises in the building, light, timber and food industries; railway, sea and air transport and the building of major highways; post, telegraph and communications; internal and foreign trade; machine and tractor stations; State farms; irrigational work of all-Union significance; the building up of State reserves and the financing of other branches of the national economy (if their development is considered of all-Union importance) are financed from Union Budget.

Republican budgets finance the development of industry and other branches of the economy of republican importance; and local budgets

only local industry and trade, agricultural measures of local importance, housing and municipal services, and cognate economy of local significance.

The social and cultural expenditure of the Union Budget, on the contrary, covers the educational and health expenditures of only the centrally managed institutions. Budgetary expenditures on similar institutions of Republican significance are controlled by the Republican central administration, whereas local budgets finance the whole mass of educational and health institutions, such as primary and secondary education, *creches* and children's homes, local institutions of social and political education, schools for training qualified workers, local press, theatres, libraries and other cultural institutions as well as the majority of all hospitals, maternity homes and similar health institutions of local importance.

The underlying idea is that social and cultural needs can be served more adequately in a decentralised manner, and consequently the funds spent on the development of these services must be allocated through the local budgets despite the fact that more than half of this expenditure is provided by allocations from the revenue of the Union and Republican budgets.

The most characteristic features of post-war financial developments were:

(1) The reconstruction of the price system in order to adjust monetary purchasing funds accumulated by the population during the war, and current wage funds, to the available supply of consumers' goods.

(2) A complete return to the pre-war role of State Budget as the main channel for the redistribution of the national income between consumption and accumulation, with a steady yearly increase in investment in the national economy.

(3) A drive for the liquidation of the consequences of the war economy, which had brought about a deterioration in the economic use of resources in construction and production; an increase in the cost of construction, a decrease in the velocity of circulating capital, and a general relaxation in economy, because the quantitive tasks of productive plans had been given over considerations of costs.

(4) A yearly increase in the revenue and expenditure of the State Budget up to 1950, in which year revenue was planned slightly below 1949.

(5) Obtaining a surplus on the State Budget every year.

(6) The yearly under-fulfillment of estimates of revenue, owing to under-fulfillment of plans for an increase of the turnover of con-

sumers' goods. This, however, was paralleled each year by an under-fulfillment of estimated expenditure so that in 1945–6 an even greater budgetary surplus was achieved than planned; and in 1948-9, in spite of the under-fulfillment of estimates, even greater absolute budgetary surpluses were achieved than in the previous three years.

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FASCISM

LUDWIG VON MISES

When the war broke out in 1914, the Italian socialist party was divided as to the policy to be adopted.

One group clung to the rigid principles of Marxism. This war, they maintained, is a war of the capitalists. It is not seemly for the proletarians to side with any of the belligerent parties. The proletarians must wait for the great revolution, the civil war of the united socialists against the united exploiters. They must stand for Italian neutrality.

The second group was deeply affected by the traditional hatred of Austria. In their opinion the first task of the Italians was to free their unredeemed brethren. Only then would the day of the socialist revolution appear.

In this conflict Benito Mussolini, the outstanding man in Italian socialism, chose at first the orthodox Marxian position. Nobody could surpass Mussolini in Marxian zeal. He was the intransigent champion of the pure creed, the unyielding defender of the rights of the exploited proletarians, the eloquent prophet of the socialist bliss to come. He was an adamant adversary of patriotism, nationalism, imperialism, monarchical rule and all religious creeds. When Italy in 1911 opened the great series of wars by an insidious assault upon Turkey, Mussolini or-

ganized violent demonstrations against the departure of troops for Libya. Now, in 1914, he branded the war against Germany and Austria as an imperialist war. He was then still under the dominating influence of Angelica Balabanoff, the daughter of a wealthy Russian land owner. Miss Balabanoff had initiated him into the subtleties of Marxism. In her eyes the defeat of the Romanovs counted more than the defeat of the Hapsburgs. She had no sympathies for the ideals of the Risorgimento.

But the Italian intellectuals were first of all nationalists. As in all other European countries, most of the Marxians longed for war and conquest. Mussolini was not prepared to lose his popularity. The thing he hated most was not to be on the side of the victorious faction. He changed his mind and became the most fanatical advocate of Italy's attack on Austria. With French financial aid he founded a newspaper to fight for the cause of the war.

The anti-Fascists blame Mussolini for this defection from the teachings of rigid Marxism. He was bribed, they say, by the French. Now, even these people should know that the publication of a newspaper requires funds. They themselves do not speak of bribery if a wealthy American provides a man with the money needed for the publication of a fellow-traveller newspaper or if funds mysteriously flow into the communist publishing firms. It is a fact that Mussolini entered the scene of world politics as an ally of the democracies, while Lenin entered it as a virtual ally of imperial Germany.

More than anybody else Mussolini was instrumental in achieving Italy's entry into the first World War. His journalistic propaganda made it possible for the government to declare war on Austria. Only those few people have a right to find fault with his attitude in the years 1914 to 1918 who realize that the disintegration of the Austro-Hungarian Empire spelled the doom of Europe. Only those Italians are free to blame Mussolini who begin to understand that the only means of protecting the Italian-speaking minorities in the littoral districts of Austria against the threatening annihilation by the Slavonic majorities was to preserve the integrity of the Austrian state, whose constitution guaranteed equal rights to all linguistic groups. Mussolini was one of the most wretched figures of history, a ridiculous braggart and swaggerer. But the fact remains that his first great political deed still meets with the approval of all his countrymen and of the immense majority of his foreign detractors.

When the war came to an end, Mussolini's popularity dwindled. The communists, swept into popularity by events in Russia, carried on. But the great communist venture, the occupation of the factories

in 1920, ended in complete failure, and the disappointed masses remembered the former leader of the socialist party. They flocked to Mussolini's new party, the Fascists. The youth greeted with turbulent enthusiasm the self-styled successor of the Caesars. Mussolini boasted in later years that he had saved Italy from the danger of communism. His foes passionately dispute his claims. Communism, they say, was no longer a real factor in Italy when Mussolini seized power. The truth is that the frustration of communism swelled the ranks of the Fascists and made it possible for them to destroy all other parties. The overwhelming victory of the Fascists was not the cause, but the consequence of the communist fiasco.

The program of the Fascists, as drafted in 1919, was vehemently anticapitalistic. The most radical New Dealers and even communists could agree with it. When the Fascists came to power, they had forgotten those points of their program which referred to the liberty of thought and the press and the right of assembly. In this respect they were conscientious disciples of Bukharin and Lenin. Moreover they did not suppress, as they had promised, the industrial and financial corporations. Italy badly needed foreign credits for the development of its industries. The main problem for Fascism, in the first years of its rule, was to win the confidence of the foreign bankers. It would have been suicidal to destroy the Italian corporations.

Fascist economic policy did not—at the beginning—essentially differ from those of all other Western nations. It was a policy of interventionism. As the years went on, it more and more approached the Nazi pattern of socialism. When Italy, after the defeat of France, entered the second World War, its economy was by and large already shaped according to the Nazi pattern. The main difference was that the Fascists were less efficient and even more corrupt than the Nazis.

But Mussolini could not long remain without an economic philosophy of his own invention. Fascism posed as a new philosophy, unheard of before and unknown to all other nations. It claimed to be the gospel which the resurrected spirit of ancient Rome brought to the decaying democratic peoples whose barbarian ancestors had once destroyed the Roman empire. It was the consummation both of the Rinascimento and the Risorgimento in every respect, the final liberation of the Latin genius from the yoke of foreign ideologies. Its shining leader, the peerless Duce, was called to find the ultimate solution for the burning problems of society's economic organization and of social justice.

From the dust-heap of discarded socialist utopias, the Fascist scholars salvaged the scheme of guild socialism. Guild socialism was

very popular with British socialists in the last years of the first World War and in the first years following the Armistice. It was so impracticable that it disappeared very soon from socialist literature. No serious statesman ever paid any attention to the contradictory and confused plans of guild socialism. It was almost forgotten when the Fascists attached to it a new label and flamboyantly proclaimed *corporativism* as the new social panacea. The public inside and outside of Italy was captivated. Innumerable books, pamphlets and articles were written in praise of the *stato corporativo*. The governments of Austria and Portugal very soon declared that they were committed to the noble principles of corporativism. The papal encyclical *Quadragesimo Anno* (1931) contained some paragraphs which could be interpreted—but need not be—as an approval of corporativism. In France its ideas found many eloquent supporters.

It was mere idle talk. Never did the Fascists make any attempt to realize the corporativist program, industrial self-government. They changed the name of the chambers of commerce into corporative councils. They called *corporazione* the compulsory organizations of the various branches of industry which were the administrative units for the execution of the German pattern of socialism they had adopted. But there was no question of the *corporazione's* self-government. The Fascist cabinet did not tolerate anybody's interference with its absolute authoritarian control of production. All the plans for the establishment of the corporative system remained a dead letter.

Italy's main problem is its comparative overpopulation. In this age of barriers to trade and migration the Italians are condemned to subsist permanently on a lower standard of living than that of the inhabitants of the countries more favored by nature. The Fascists saw only one means to remedy this unfortunate situation: conquest. They were too narrow-minded to comprehend that the redress they recommended was spurious and worse than the evil. They were moreover so entirely blinded by self-conceit and vain-glory that they failed to realize that their provocative speeches were simply ridiculous. The foreigners whom they insolently challenged knew very well how negligible Italy's military forces were.

Fascism was not, as its advocates boasted, an original product of the Italian mind. It began with a split in the ranks of Marxian socialism, which certainly was an imported doctrine. Its economic program was borrowed from German non-Marxian socialism and its aggressiveness was likewise copied from Germans, the *All-deutsche* or Pan-German forerunners of the Nazis. Its conduct of government affairs was a replica of Lenin's dictatorship. Corporativism, its much adver-

tised ideological adornment, was of British origin. The only home-grown ingredient of Fascism was the theatrical style of its processions, shows and festivals.

The short-lived Fascist episode ended in blood, misery and ignominy. But the forces which generated Fascism are not dead. Fanatical nationalism is a feature common to all present-day Italians. The communists are certainly not prepared to renounce their principle of dictatorial oppression of all dissenters. Neither do the Catholic parties advocate freedom of thought, of the press or of religion. There are in Italy only very few people indeed who comprehend that the indispensable prerequisite of democracy and the rights of men is economic freedom.

It may happen that Fascism will be resurrected very soon under a new label and with new slogans and symbols. But if this happens, the consequences will be detrimental. For Fascism is not as the Fascists trumpeted a "new way to life"; it is a rather old way toward destruction and death.

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A REVIEW OF THE NATURE OF OUR ECONOMIC SYSTEM

REUBEN E. SLESINGER

IT IS IMPERATIVE TODAY that each of us understand the objectives, institutions, and principles of our economic system and the mechanism through which it operates. Our system has developed certain traits during the years of its life. We must consider it as a complete and functioning organism. Only through such an analysis and comprehension of the roles played by the major members of our society may we be fortified to meet attacks.

To begin with let us guard against delimiting the role of economics to a study only of man seeking to satisfy his material needs. On the contrary, it is a much broader and more significant study. When men join and work together in cooperative endeavors for the production of various goods and services, economic problems arise. These problems become more complex when government is introduced into the picture *as an arbitrator or as a participant.*

A successful economic system must guarantee the component members the fulfillment of certain basic and fundamental requirements. To begin with, there must be an inducement to people to work so that the group will be supplied with the goods and services necessary for its standard of living. Then, it should lead to the production of the kinds and quantities of goods and services that the people want; that is, it should bring about a matching of production with needs. Next, it should make it possible for the workers to do the kind of work that they desire to do. Finally, it should not only determine how the goods and services that are produced will be divided but it should also take care that this distribution be equitable.

Thus, we see that our economic system is an organization of society into a team that works cooperatively to produce the goods and services that are required of its component members.

During the course of its relatively short history so far as the world is concerned, the United States has undergone vast changes in its economic system with a consequent growth in the complexity of its economic problems. Let us for a moment take a look at the vast changes that have taken place in the life of the typical resident of the United States between 1820 and 1949. At the earlier period, the typical American was a farmer who worked on his own farm, who lived in a house built by himself or with the aid of a few neighbors, and who wore home-spun clothing. Over seventy-five per cent of the working population earned its living by farming, lumbering, or fishing. A century later, this figure was reduced to twenty-five per cent.

In these earlier days, the farmers, tradesmen, and craftsmen worked mainly for themselves and not for others. Few people worked at full-time jobs for wages. Annual money incomes were surprisingly small. As a matter of fact, money and money incomes were not nearly so important as they are today. Most of the individual's real income came from the person's own land and labor. In addition, each small town or village would exchange its goods only within a nearby small circle because of the physical difficulties of transportation and communication. Prices of home-grown produce were low, but costs of manufactured goods were quite high. It is reported that West of the Allegheny

Mountains a suit of store clothes would cost about as much as a farm.

Thus, we see that the typical citizen of 1820 was relatively self-sufficient. His counterpart today is a very interdependent individual. He produces very little directly for his own family consumption. This remarkable change in the structure of the American economy has an important bearing upon our understanding of the workings of our American economy. The individual, operating under such a complex economic milieu, finds it difficult to comprehend the inner-workings of all these relationships. Lack of understanding breeds suspicion and mistrust. These conditions are inherent in our complex and highly productive economic system, in our vast national and international distribution and marketing structure, and in our money economy.

This increased complexity and efficiency of our American economic life was one of the major results of the Industrial Revolution that took place during the late eighteenth and early nineteenth centuries. This change brought the great inventions in the textile industry, the development of the steam engine, the growth of division and specialization of labor, and the development of markets.

It is at that time that we begin to find the germs of most of our current economic problems. New problems concerned with the stability of employment and business activity and their manifestations of mass unemployment and the swings of business from boom to depression arise. However, these problems are not all unmixed disadvantages. The very objectives of economic activity demand aggressive and dynamic economic changes.

Each of the major economic systems that have developed out of our various political and social philosophies has sought the ends of progress and stability, but each of these applications of the particular philosophies has set up different means for attaining the universally desired ends. The American system of individual capitalism has developed its own basic institutions and principles that cannot be changed or violated without destroying the fundamental character of the system. *It is imperative that we keep these basic institutions and principles in mind when it comes to passing upon the effectiveness of public policy.*

Let us look at the more significant of these pervasive principles. First, there is the institution of private property. Without this, individual capitalism cannot exist. Next, come the related institutions for the privately owned business firm. Each of these units enjoys the freedom to produce what and how much it will, subject to its ability to satisfy the needs of its customers. Then, there is the individual freedom of choice—freedom to act, to succeed or to fail. Fundamental, too, is the

principle of free and active competition among business firms for the customers' dollars. Finally, we have the principle that the goods and services produced should be distributed in proportion to the value of the respective contributions to production.

It is instructive to note how distinctive these principles and institutions are to individual capitalism and how they differ from the corresponding principles of other economic systems. Communism attempts to abolish the institution of private property and to eliminate the private business firm. British socialism attempts to exclude private ownership from certain major industries. Individual freedom of choice and initiative are almost completely absent in the Soviet system and to an increasing extent under British socialism. Individual initiative and planning are replaced more or less by over-all planning of production and distribution by central government agencies. Private competition, thus, gets replaced by state monopoly.

The over-all purpose of these institutions and principles of individual capitalism is to induce the members of a cooperative society to work together energetically and effectively. The success of an economic system depends primarily upon how completely it provides these incentives for greater effort, more skill, and increased production. The outstanding national systems that now are in vogue—American, British, or Russian—may be evaluated according to this standard of measurement. These different systems may be expected to succeed in reaching the goals of greater production and stability to the extent that each contains these necessary incentives to production. Moreover, the system, to be successful, must offer adequate and fair rewards for working and for saving. The American economic system has been molded around three basic divisions: the factors of production, the money and banking system, and the pricing mechanism. The money mechanism is one element of the economic system that is a necessity in any cooperative society.

As an over-all agency cutting across these various institutions we find government. The American Constitution deliberately provided for a weak central government of divided powers. It is no accident that the United States has grown to be the richest and most powerful nation in the world. But, even with its limited constitutional government, our government plays a major role in the economic life of our nation.

There have been other factors which have contributed no small part to our tremendous development. Rich natural resources are a basic requirement. Although only about seven per cent of the world's

population lives in the United States, the country accounts for about twelve per cent of the world's food supply and for a much larger share of the manufactured products. The United States still possesses a larger share of the world's resources of the more important minerals than any other nation.

Our American economy of recent years has undergone several basic changes. Among these we should include the growing role of activity given to government, the increased influence of labor as a pressure group, and public interest in more private business. Thus, all in all, our economy continues to function basically as a private system of individual capitalism and gives us the highest standard of living in the world.

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THE NATURE OF FREE SOCIETY

HAROLD W. METZ and CHARLES A. H. THOMSON

THE WHOLE WORLD is now torn by the struggle between nations and groups of nations, and between individuals and groups within nations, over the basic principles underlying free societies and controlled societies. This conflict is illustrated every day by the ever-recurring, never-ending disputes between the United States and Soviet Russia; it was dramatized earlier by the challenge of Fascist Italy and Nazi Germany not only to international peace, but to free institutions everywhere. It is further emphasized, perhaps in more critical fashion, by the arguments within customarily free societies between those who would give aid and comfort to the philosophies and systems of the dictators, and those who hold to the values and principles of freedom

for all individuals. The conflict is involved and often too little dramatized in the proposals for extension of societal control, which in themselves represent no great derogation to the dignity or scope of the individual, but collectively mark the road to total domination.

The main ways in which these controlled societies differ from their free counterparts is in the value, position, and role of the individual in his relation to society. A free society rests on the basic premise that it is organized solely to facilitate the efforts of each individual to conceive and to achieve his ends. In it society as such has no life, values, or ends apart from those of the individuals which compose it. The controlled society, on the other hand, rests on the premise that the social organization has reality, ends, and values of its own, and that individuals are valuable only as a means to achieve society's purposes. In other words, the individual is a tool or a means, not an end in himself. These two opposing views of the position of the individual in society have long made conflicting claims on the allegiance of thinking men.

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The fortunate inhabitants of free societies are prone to underestimate the rigor and completeness of control within totalitarian ones. They often assume the universality of their own liberties, and lack first-hand knowledge of totalitarian regimentation. They often discount the reports of those who do have first-hand knowledge, and disbelieve the frank statements of totalitarian leaders about the measures they apply to the regimes they dominate. They fail to understand the integral nature of totalitarian society, and consider it possible to incorporate certain desirable features of such systems without concomitant personal regimentation or increased temptation to shore them up by further features of less honorable character. Or others among them may admit extension of control, but justify it by arguing that such losses of liberty are transitory, and more than offset by achieving a higher and more meaningful freedom.

The evidence shows that the governments of controlled societies characteristically establish far-reaching regulations—many of them arbitrary and capricious—that touch upon every aspect of the life of the individual.

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In our view, there are a number of assumptions basic to the idea of the freedom of man in society.

One of these is that the sole legitimate role of the state is to make possible the maximum self-realization of each individual by creating an environment in which he can develop in his own way, primarily by applying his own efforts and resources. This basic goal and its necessary conception of method rests on the belief that each man is a rational thinking person who knows better than anyone else what things contribute to his enjoyment and to his highest welfare. The free society does not assume equality of tastes, talents, or capacities, but recognizes that men differ on these points. Taken together, these propositions form the basis of equality of rights and of procedures in making group decisions. So far as possible, all persons must have equal opportunity to develop their own facilities in their own way.

Diversity of individual capacities leads to a desirable diversity of interests. Since individual interests are varied, dissimilar things give satisfaction to different people. Individuals pursuing various interests make new developments, new scientific and technological discoveries, and new products. Ideas germinate, and a variety of economic, social, and cultural institutions and practices flower. Where there is success, others will seek to match or improve; the failures warn intelligent people not to make the same mistakes again. Obviously, a diversity of tastes cannot fit into the uniformity and rigidity that are generally found in programs of government control over the individual.

Genuine individual improvement can come only through the efforts of the individual himself, working alone or in groups of his choosing. Insofar as government tries to do for the individual what he should do for himself, it diminishes his scope to improve himself by his own efforts. This may not be so important in the material realm as in the realm of mind and spirit. Only as government by its provision of services and its administration of social discipline makes it possible for the individual to better his position, can it be said that the government contributes to progress. The individual cannot be forced to be wise, to be good, or to be free.

The freedom of individuals is not unlimited. No individual should exercise his legitimate freedom in such a way as to diminish the freedom of others. Every individual, in his own interest, needs regular, just, and efficient means for controlling and resolving the conflicts inevitable in human association. Unlimited freedom for each and every person would result in complete anarchy, involving the utter destruction of the freedom of all men. In a society without public authority adequate for keeping the peace, each individual

would have to devote most of his efforts and time to protecting himself from the encroachment of others. Where peace and order are wanting, physical might and intelligent cunning become the prime requisites for survival. Civil society provides an environment wherein the individual is in a position to develop and exercise more varied and valuable talents.

The scope and functioning of the state must be limited. The most important limitation is stated in our first and fundamental assumption. Other limitations of nearly equal importance are the requirements that the state must act only as authorized by law, and solely as an agent of the sovereign people. The citizen is always the master, the government the servant. Hence freedom requires that government act in accordance with clear legal authority. Public officials are responsible not alone for broad results, but also for the legality of all their public acts.

The existence of personal rights against the government is a necessary part of the idea that government is only an agent. Such rights are not inherent in democracy as such. It is conceivable that a democracy might provide by democratic procedures that the state is supreme within certain areas, and the individual has no right which he can urge against it. But personal rights against the government, procedural or concrete, are an inescapable element of the free society which insists that political freedom rests on limitation of government and rejects the totalitarian assertion that no individual interest is ever more important than the interest of the state.

For such personal rights to have substance, the state must provide to the citizen machinery adequate for testing the legality of the acts of government servants. Courts must be in operation where the individual can test the propriety of any act of government against the established law of the land. The state may arrest, imprison, search the domicile, or seize property, but it may not do so arbitrarily or without regard to the objects and procedures established by law. To have it otherwise is incompatible with free society.

The form of government of a nation does not of itself guarantee freedom. The quality of political freedom depends on the position of the individual with respect to his government. Democracies are commonly supposed automatically to guarantee freedom, since they are assumed to operate according to the will of the people. Actually, democracies unfettered by constitutional restraints may indulge in some of the worst forms of domination and exploitation of individuals. Democracies frequently operate on the assumption that each and every individual or minority group can be rightfully subjected to any de-

cision of the state because its determinations represent the will of the majority of society, and the majority knows what is best for the group as a whole. Thus an unlimited majoritarian democracy could suppress freedom of speech on the ground that no individual should be permitted to question or criticize the will of the majority. It might arbitrarily arrest and imprison as a means of imposing on the intransigent individual the will of the then preponderant group.

In a free society the state is only one of many forms of social organization. The claims of the state on the individual are not necessarily prior to those of any of the other organizations which make up society. This results both from the nature of the individual personality, from the view of the primacy of the individual, and from the very form and methods of operation inherent in the state. The individual cannot attain his maximum self-realization without participation in groups. Many of the interests of men can best be attained through voluntary associations composed of like-minded people. Only in such groups can most people satisfy their craving for fellowship, pursuit of common interests, and spiritual solace. By organizing groups with a common purpose, members of society can increase their resources and power and can attain objectives impossible to individuals acting independently. Labor unions, business corporations, agricultural co-operatives, and universities exemplify this role of groups for the individual.

The purposes of group life, so conceived, cannot be achieved by the state alone. No single pattern of association will fit the diversity of human nature and the variety of interests of men. Membership in several organizations enables the citizen to give expression to the many facets of his personality and to the changing significance of his various interests under rapidly shifting conditions. It enables the citizen to choose whichever of his interests is dominant as against any other, and to support the group that furthers the one he favors. Being a member of a labor union and a consumers' co-operative, he might support the latter against the former. Being a member of a church and a fraternal organization, he might support the former, in any temporary conflict of interest, or withdraw from one or the other, if his interest and conscience so moved him because of an enduring rift.

Two inherent aspects of the state make desirable a multiplicity of voluntary associations. The first of these is its nonvoluntary universality. The state embraces every person within its boundaries, whether he wills it or not. If the state treats all citizens equally, as it must to be just, it cannot give appropriate emphasis to the differing wants of diverse individuals. Second, the state is the only organization which

by right can utilize physical force as a sanction to enforce its decisions. The potentiality of physical compulsion reduces the usefulness of the state as a social device in some fields. This is especially true in those fields where faith, belief, and reason are involved. The state, by force, should not and cannot impart real religious conviction or intellectual agreement. To use force for such purposes creates more antagonism than good. Outward conformity may be purchased at the price of inner disrespect, resentment, and disaffection.

Finally, the claims of the state on the individual cannot be presumed to be prior to those of any voluntary organization, or of the conscience of the individual. The state, as guarantor of the conditions of a good life, makes claims which are entitled to high consideration, but these claims must be judged by individuals and groups according to their merits. Furthermore, the state is not a mystical body, acting infallibly through human agencies. The state in effect is government, and is no better or wiser than the servants acting for government, or the people participating as legislators, executives, judges, or citizens in forming the decisions or carrying out the processes of government.

Authority and power must be diffused among groups and individuals. No one group or section of the community—corporation, labor union, religious group, or the state itself—can enjoy so much power that it can dominate individuals or other groups to the point where their formal freedoms become a mere sham. Such power need not be public or political in the ordinary sense of the term; it can be economic, social, or religious. If it is over-concentrated, it spells the death of freedom. A free society will remain free only so long as the control of the means of production is divided among numerous people acting with a large degree of genuine autonomy. If the direction of all means of production, or all of a key sector of production, is in a single hand, be it government or be it trust, that authority has complete power over all the people.

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HOW GOOD IS THE AMERICAN ECONOMY?

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How GOOD are American economic institutions, and by what tests should they be appraised? Do they stand up well under various non-economic as well as economic tests? Are they consistent with the democratic philosophy? Are they likely to hold their own in competition with other economic and political institutions? Will they enable America to maintain a position of leadership in the sphere of economics, and even more important, in other fields as well? In short, do American economic institutions provide a favorable environment for the building of a great civilization? Now that private enterprise is under strong and persistent attack by Russia, it is especially important that Americans have definite ideas concerning what they expect of their economy, and that they observe whether or not it meets their tests. Let us examine first how well the economy meets certain economic tests, and then some non-economic ones.

I

What principal economic tests should the economy meet? It should be good in increasing output; it should give people reasonable security and abundant opportunities; it should adapt itself readily to new conditions; it should distribute its product fairly; it should maintain a fair balance between the interests of consumers and the interests of producers; it should distribute a reasonable amount of product on the basis of need; it should not permit incomes to be acquired in uneconomic ways. How well does the American economy meet these tests?

1. Is the economy good at increasing output per man-hour? The answer to this question is obviously yes. The success of the economy

in raising output per man-hour . . . is due fundamentally to the large number of enterprises and to the fact that each operates in the main independently of the others, so that each is a center of initiative, and so that there is widespread rivalry among them.

2. Has the economy provided people with reasonable security and abundant opportunities? Arrangements are badly needed . . . to assure that the economy operates more steadily, and more adequate compensation needs to be provided for the unemployed. In a progressive and competitive economy, however, some jobs are always being destroyed by technological and market changes and some firms are being forced out of business. This insecurity needs to be compensated by opportunity—that is, by an increase in jobs and in business openings. Judged by this test, the record of the economy is excellent. Jobs have increased faster than population, and the economy has given people a more and more abundant choice of employers and occupations, a chance to advance, and a good opportunity to enter business for themselves. Let us look briefly at these matters. In 1870, for example, less than 44.4 per cent of the population of ten years of age or over was in the labor force. By 1900 the proportion was 50.2 per cent; by 1947 51.6 per cent. About 1.5 million of the 3.8 million enterprises outside of agriculture regularly have employees. This gives workers a wide choice of employers, and the movement in and out of the labor force gives people a good chance to exercise this choice. The number of occupations is being constantly increased. The electric light and power industry, the electrical-equipment industry, the petroleum industry, the chemical industry, moving pictures, radio, the automobile industry, and the air-transport industry, have all brought with them a host of new occupations. As the number of industries continues to increase, the number of occupations will also grow. Some occupations, of course, are extinguished by technological change, but the main effect is to increase the number of occupations.

Technological progress . . . seems on the whole to increase the demand for skill, although instances where it has had the opposite effects are easy to cite. The demand for speed and precision, however, seems to be insatiable, and there is an underlying tendency to give the individual worker more and more apparatus to manage. These trends increase the demand for skill. The growing use of apparatus increases the importance of the occupations concerned with maintenance and repairs—skilled occupations that demand ability to detect the source of trouble and to make the kind of repair or adjustment needed to remove it.

Finally, new businesses are fairly easy to start. Although the ratio

of self-employed to employees has been declining, over ten million out of a labor force of roughly sixty million have elected self-employment. The number of business concerns outside of agriculture has more than doubled since the beginning of the century, Furthermore, it has increased faster than population. In 1900 there were twenty-one firms for each thousand persons; in 1947, twenty-six firms per thousand persons. Indeed, at the end of 1947, the number of enterprises outside of agriculture stood at an all-time high, 29 per cent above 1929, and about one third above the wartime low. About 200,000 business births (as distinguished from transfers of existing firms) occur in an average year. The high mortality among new concerns suggests that it may be too easy for poorly qualified people to go into business.

Excellent as has been the record of the American economy in providing opportunities, serious shortcomings remain to be corrected. There is a wide disparity of educational opportunities in different parts of the country. Furthermore, in all parts of the country educational opportunity is still unduly dependent upon income—although less so today than formerly, and less so in the United States than in almost any other country. Progress in providing educational opportunity is indicated by the fact that between 1890 and 1940 the number of high-school graduates increased about sixteen times as fast as the population. The country has also failed to give adequate employment and educational opportunities to Negroes. This is less a failure of economic institutions than of social attitudes. Encouraging progress has been made in recent years in reducing discrimination against Negroes, but much still remains to be done. Within business concerns the problem of promoting on the basis of merit is still far from solved—though some organizations have made much progress in developing regular lines of promption and in making selection less dependent upon the judgment of any one person.

3. Does the economy adjust itself effectively to new conditions? On the whole, the answer to this question seems to be yes. Public policy, it is true, often moves slowly and timidly, avoiding issues until a large part of the community sees that a problem exists and demands action. This waiting for the people to insist on a public policy is inevitable in a democracy. Business concerns, however, do not have to wait for the public to demand action, and hence are usually quick to adapt themselves to changes. Every one of the millions of enterprises is a point of contact between industry and the conditions under which industry operates, and each is able to act independently in determining how to meet a new condition. If a given type of raw material is becoming scarce, hundreds or thousands of concerns may

experiment with substitutes. If a new machine or process becomes available, scores of enterprises are ready to try it out under different conditions. Many concerns are always ready to test the desire of customers for changes in the kind of goods offered to them.

The adaptations made by individuals and by business enterprises are, of course motivated by self-interest, and are made without regard to their effect upon the community as a whole. Some of them call for corrective action by public policies. The failure of the economy to enforce more effectively the interests that all or most members of the community have in common is undoubtedly one of its major weaknesses. Most of the decisions of business managements, however, are in the public interest. They result in conserving scarce resources, increasing the efficiency of men and equipment, or adapting the product more closely to the preferences of customers. Consequently, the advantages of having adaptation occur in the main through the decisions of thousands of managements or millions of people outweigh the disadvantages. The method places at the disposal of the community much knowledge and interest that would be lost if decision making were concentrated in a few central planners.

4. Does the economy distribute its product widely and fairly? There is considerable concentration of income. About 20 per cent of spending units receive 47 per cent of money income, and 30 per cent of the spending units receive only 9 per cent of the money income of the country. Concentration of income, however, does not necessarily mean that income is unfairly divided. That depends upon one's conception of fairness. If one believes that income should be distributed in accordance with the contribution of individuals or their property to output as measured in competitive markets, one would expect a fair amount of concentration—at least if human abilities are distributed more or less in accordance with a normal distribution curve.

I shall not discuss different concepts of fairness in distribution. Some people believe that incomes should be based upon contributions to production; others believe that incomes should be based upon need; still others believe that fairness consists of a compromise between distribution in accordance with productivity and distribution in accordance with need. Probably most persons accept this third criterion of fairness, but they differ with respect to how productivity should be measured, and also with respect to how far incomes should be based upon need. I wish simply to call attention to a few facts concerning the distribution of income—facts that the reader may find useful in judging the fairness of distribution.

One significant fact is the relationship between changes in wages

and changes in average output per man-hour. During the last several generations, earnings of workers per hour seem to have more than kept pace with the rise in output per man-hour. In 1940, hourly earnings of nonagricultural workers were about eight times as high as in 1840. Physical output per man-hour was about six times as high. The index of wholesale prices shows a rise of about 10 per cent, but . . . this index has an upward bias. The real price level in 1940 was slightly below the price level of 1840. It is plain, however, that the wages of employees have fully kept pace with the rise in average output per man-hour.

A second significant fact that bears on the fairness of distribution is the proportion of income going to property. . . . Capital per worker has been rising, but . . . the share of the national income going to property has been dropping—in 1940, reproducible wealth per worker was about three times as large as in 1880, but the share of income going to property had dropped from more than one fourth in 1880 to about one fifth in 1940. In 1947 it was about one sixth. These figures may suggest that property owners are not receiving a fair share of the national income. The mere fact that the share of property has dropped as capital per worker has gone up does not, however, prove that property owners are being unfairly treated—even if one accepts the proposition that incomes should be determined in the main by contribution to production. As capital per worker increases, the drop in the marginal contribution of property to production may prevent an increase in capital per worker from increasing the proportion of output going to capital. The figures do indicate, however, that there is no basis for the oft-expressed fears that incomes are becoming concentrated in the hands of property owners.

A third significant fact that bears on the fairness of the distribution of income is the shift during recent years in favor of the low-income recipients. This shift, of course, does not prove that income is more fairly distributed today—possibly the low-income recipients have gained unfairly. Between 1941 and 1946, however, the average real income of the lowest fifth of the families increased by 68 per cent; of the next lowest fifth, by 59 per cent; and of the highest fifth, by 20 per cent. Between 1935-6 and 1946, the proportion of all income going to the highest fifth of the families dropped from 53.2 per cent to 46.8 per cent.

Two serious inequities in the distribution in income are inadequate compensation for pioneering and risk taking and inadequate compensation for holders of fixed-income securities. Inadequate compensation of risk bearing and pioneering is a result of the sharply

graduated surtax and the absence of sufficient offsets for losses. The recipients of fixed incomes have been badly treated in the last few years —as always happens when there is a war. Perhaps the buyers of bonds should be regarded as taking the risk that the price level may rise. Possibly people who buy or accept pensions should be regarded as taking the same risk. The buyers of bonds in past years, however, could hardly be regarded as contemplating the possibility that the government would depress interest rates as severely as it has done. The drastic depressing of interest rates has been defended as a way of reducing the cost of the war. It did not reduce the real cost of the war—it simply meant that the government picked out a small part of the community—the owners of fixed-income securities—to pay a particularly large share of the cost.

5. Does the economy provide a reasonable balance between the interests of consumers and the interests of producers? Producers and consumers, of course, are to a considerable extent the same people, but this does not mean that the interests of consumers and the interests of producers do not clash. As consumers the people wish to obtain each article for a minimum expenditure of their incomes. As producers, they wish to work without too much fatigue under pleasant, safe, and sanitary conditions, they wish to work steadily, and they wish the largest possible compensation for their services or the largest possible return on their invested funds. The national product is maximized when there is a proper balance between people's interests as consumers and their interests as producers. Neither consumers nor producers are content to let uncontrolled markets determine the way in which budgets and costs fall upon consumers and producers. Both groups sponsor laws and public policies intended to modify the results that markets produce.

In the nineteenth century, employment policies and conditions of work were determined pretty largely in favor of consumers—undoubtedly too much so. Men were hired only when their services were immediately needed, and dropped when the need disappeared. Consumers also obtained goods without paying a sufficient amount in many cases to make possible safe, sanitary, and pleasant working conditions. In the matter of wages, however, employees fared much better. . . . The effect of technological progress was primarily to raise money wages rather than reduce the prices of goods. Hence most of the gains of technological progress went to people in their capacity as employees rather than in their capacity as consumers. The tariff is an example of another area in which the interests of producers dominated public policy. So high were tariffs on many

products that virtually no foreign-made goods came in to compete with the domestic products.

Today the interests of producers seem in general to be more effectively protected than the interests of consumers. It is true that there are important respects in which protection has been given to consumers—the pure food and drug acts, legislation regulating the issuance of securities and dealing in securities, regulation of the maximum charges of railroads and public utilities. Likewise, the position of consumers has been greatly improved by the rise of chain stores, mail-order houses, and department stores, which have given consumers abler and more powerful purchasing agents than they have ever possessed. On the whole, however, the developments of the last several generations seem to have been mainly in favor of producers. Many states have passed laws authorizing a manufacturer to fix the prices that retailers charge for his product. Much legislation has been passed in the special interest of employees. The rise of powerful trade unions has greatly strengthened the position of employees. It looks as if wages would be fixed primarily in the interest of employees and that wage policies will require, as I have pointed out, a slow rise in the price level. One producer group for which little consideration has been shown, however, are the owners of business enterprises and the providers of investment-seeking funds.

6. Does the economy distribute enough income on the basis of need? How much is "enough"? In 1946, social-insurance benefits, old-age assistance, workmen's compensation payments, public relief, and various other payments based on need such as private pensions and fellowships (exclusive of mustering-out payments to soldiers) were about $9.5 billion, or 5.3 per cent of all personal incomes. These payments were about 70 per cent more than the total dividend payments of all American corporations, and nearly 22 per cent more than all corporate profits after adjustment for inventory gains. In Oklahoma more than half of the persons of sixty-five years or more receive old-age assistance, and in several other states old-age assistance is given to more than four out of ten persons of sixty-five or more. During the last twenty years there has been a rapid rise in incomes distributed on the basis of need. In 1929, payments under workmen's compensation plans, old-age pension plans, old-age assistance, and unemployment compensation were about $1.3 billion, or 1.5 billion, or 3.9 per cent of all personal incomes.

In addition to cash incomes based upon need, the government provides many free services, such as free primary and secondary education, fire protection, police protection, and the free use of many public

facilities, such as parks, roads, and bridges. In fact, nearly all of the services provided by the government, which are about one eighth of the total output of the country, are free to the particular individuals who use these services—although the cost of providing them falls upon the community.

Despite the great increase in incomes based upon need, much still remains to be done to protect people against want. For example, the federal old-age pensions law applies to only about three out of five jobs. . . . The coverage of unemployment compensation and workmen's compensation is likewise incomplete, and the compensation paid is usually too small. One of the most serious lacks is the absence of insurance against total disability for long-extended duration. On any day about 2 million persons are kept from gainful work by disabilities that have continued for more than six months. Although most workers now have old-age pensions and life insurance, protection against loss of income from total disability is not generally available. Another serious lack is the absence of free medical service and the absence of cash sickness and disability benefits. It is obviously preposterous that any one should fail to obtain medical service because he is unable to pay for it, or that he should have to receive medical service as charity rather than as a right.

7. Does the economy permit a substantial amount of income to be acquired in uneconomic ways—that is, by misrepresenting goods, by restricting production, by shifting real costs of production to workers or to the community, or by wasting resources? No reliable estimate of the amount of income acquired in uneconomic ways is available. The difficulties of making such an estimate are perhaps insuperable because many incomes are acquired by a mixture of economic and uneconomic ways—as when an article is represented to be better than it is. Perhaps someone will attempt to make rough estimates of the size of the principal forms of uneconomic incomes. An annual estimate, with a classification of the particular types of uneconomic income, would spur the community to eliminate these forms of income.

Considerable progress has been made in recent years in reducing the opportunities to earn a living in uneconomic ways—particularly by misrepresenting goods or unfairly shifting costs. Pure food and drug acts, the securities and exchange act, the introduction of standard grades, are all examples of the attack upon misrepresentation. Workmen's compensation laws and zoning ordinances illustrate efforts to prevent the unfair shifting of costs. Possibly some progress has been made also in discouraging the growth of monopolies. Certainly the laws against combinations are enforced more vigorously than in the past. The vigor of competition, however, depends largely upon the rate at

which industry is attempting to expand. Tax laws, which make risky ventures less attractive relative to safe ventures, probably reduce the vigor of competition more than do all of the efforts of business men to create understandings and combinations. Likewise, rapid technological progress has probably done more than the anti-trust laws to keep competition keen.

Men will always be inventing uneconomic ways of making a living. Indeed it is part of the essence of private enterprise that men have great opportunities and great incentives to obtain incomes in new ways. Some of the new ways will add to the total national product; others will subtract from it. Consequently, the community must always be vigilant to prevent men from acquiring incomes in ways that reduce the net output of industry.

II

Does the economy meet the non-economic tests that should be applied by a civilized community? Four tests are particularly important. In the first place, industry should be so operated as to respect human personality and to treat its workers as human beings rather than machines. In the second place, the conduct of industry should be favorable to the development of the non-economic activities of the community. This means that it should be favorable to the development of ideas, experiments, and thinking in the arts and sciences—in literature, art, philosophy, science, and religion. In the third place, the economy should furnish a favorable environment for democratic institutions and processes. In the fourth place, economic institutions should help build a satisfactorily balanced scale of values—that is, a scale of values in which the interests that all members of the community have in common are ranked high in relation to the interests of individuals or of small groups. How satisfactorily does the American economy meet these four tests?

1. Is industry operated with proper regard for its workers and their needs as human beings? Are employees protected from arbitrary treatment by supervisors, and are they given a good chance to grow and to improve themselves? During the last generation there has been virtually a revolution in the managerial methods of many concerns, especially large ones, but much still remains to be done. Most large concerns have deprived foremen of arbitrary authority to make such decisions as who is to be promoted or laid off, or what discipline is to be imposed in a given case. The foremen simply make recommendations to a superior or to a personnel department. Shop rules have been instituted which gives employees rights and which super-

visors are expected to observe. A check on the treatment of employees by supervisors is sometimes made by "exit interviews"—interviews with all men who resign. The rise of trade unions has helped to spread better managerial practices, because unions introduce into industry arrangements by which the decisions of management may be challenged. Their influence is important even in many shops where employees are unorganized.

Developments of extreme significance are on the point of occurring in American management. Business heads are making systematic efforts to determine what employees think of their jobs, and what, in the employee's mind, are the elements of a "good job." Some managements, such as those in General Electric and Lever Brothers, are attempting to make every job in the enterprise satisfy the elements of a good job. They are arranging for each supervisor regularly to interview every employee under his direction, and for management to keep in touch with what employees think about their jobs and their supervisors. By and large, the outlook is bright in American industry for more understanding and humane treatment of employees than has ever occurred in the history of the world.

2. Are the economic institutions of the country favorable to the development of great work in non-economic fields, such as art, literature, religion, science, and philosophy? Is artistic or intellectual life controlled in the interests of particular economic groups, is originality throttled, is the artist or thinker denied a fair opportunity to criticize the powers that be or to seek acceptance of new ideas, new conceptions of art? Artists, writers, philosophers, and editors could perhaps answer this question better than economists. Doubtless every one of them is impressed by the fact that the market makes demands on him which he does not like. Certainly the demand for trash is tremendous, and the temptation to cater it is great. It is also true, however, that the economic institutions of the United States are exceptionally favorable to competition in the field of new ideas. They give sponsors of new ideas in the fields of art, philosophy, science, or religion an excellent chance to win converts or to find fault with prevailing ideas or established canons of taste. There are several reasons for this:

a. The opportunity to pursue the arts while holding routine business or industrial jobs is good. The champion of a cause need not be too concerned over what his employer (if he has one) thinks of his ideas, because there are plenty of employers.

b. There is no official censorship, no party line to be observed, no ideological tests to be met, no Zhdanov to lecture the artistic community on the state of its work, and no Central Committee publish-

ing a *Culture and Life* for "the purpose of promoting criticism of deficiencies in ideological work."

c. The fact that markets in the main are private means that the original thinker or creative worker is free to seek customers wherever he can find them. The customers may be individuals, municipalities, lodges, clubs, trade unions, churches, or corporations. Hence it is possible for men to make livings (and not infrequently good ones) by crusading for new ideas, by producing work that affronts accepted canons of taste, by publishing books and magazines of protest. Perhaps it is too easy to do these things. Undoubtedly the country would get better work if buyers were harder to please. These observations, however, are not criticisms of the economic institutions of the country. These institutions give workers in the arts a peculiarly favorable opportunity to produce free from control by the government, the church, business, or other established institutions, and to win support wherever they can find it. Americans may take pride in the fact that no community has ever given wider latitude to critics of its institutions than does the United States.

3. Does the economy furnish a favorable environment for democratic institutions? Many people believe that the thinking of the community is largely controlled on behalf of powerful economic interests, that political parties are simply the creatures of economic groups, and that the rise of powerful economic organizations has largely emptied democratic forms of their significance. There can be no doubt that well-organized groups have influence in politics far out of proportion to their numbers—as is indicated by innumerable privileges, subsidies, and favors conferred on special groups. The fact that unorganized individuals frequently have scant attention paid to their interests is regrettable and may be regarded as a defect in democratic institutions. It does not mean, however, that these institutions have lost their significance or have failed rather completely. It does, of course, mean that democracy has the problem of maintaining a proper balance between the representation given to interests most members of the community have in common and that given to the interests of small groups. Although the influence of various small groups upon this or that aspect of public policy is considerable, there is no pronounced concentration of economic control—no dominant economic group that controls the government for its own purposes.

Two basic characteristics of private enterprise explain why it is favorable to democracy. One is that, under private enterprise, critics, dissenters, and rebels of all sorts do not find too great difficulty in making a living. The multitude of employers is helpful to the rebels.

So also are the numerous opportunities for self-employment and the ease with which new enterprises can be started in many lines of business. Indeed, crusading for reform under private enterprise may be a good way of making a living. Certainly no other economic institutions offer the dissenter an equally good chance to support himself by crusading for change. Democracy would operate under a heavy handicap if organs of opinions and expression were all government-owned—if every newspaper, every magazine, every play, every book, every moving picture, and every radio program were produced by the government.

A second reason why private enterprise is favorable to democracy is that under it power is divided and widely dispersed. There are holders of great economic power, such as business leaders and trade union leaders. There are also holders of great political power. Control of all production by the government would substitute concentration of power for the present wide dispersion of power. The present division of power between political leaders, industrial leaders, and labor leaders may be compared to the division of power between the Church and the State. The separation of the Church and State which has been characteristic of western Europe undoubtedly provided a favorable environment for the growth of the democratic philosophy. In eastern Europe, where the Church was subordinate to the State, there was no effective challenge to the extreme claims of the State. Hence people were led to continue to accept the idea that no one possessed rights against it.

Striking evidence that the American economy and political institutions are favorable to democracy is furnished by the rise of the labor movement. Trade unions were bitterly and vigorously opposed by employers, who were the dominant group in the community. Nevertheless, unions grew until today they are the most powerful economic organizations the country has ever had. The rise of trade unions in the face of strong opposition from employers is an encouraging fact. It should fortify the faith of Americans in their institutions, because it means that other shifts of power can probably be achieved gradually, peacefully, and in the face of strong opposition from established interests.

4. Do the economic institutions of America help build a satisfactorily balanced scale of values? The scale of values of the community determines what importance is attached to purely individual interests, to group interests, and to the interests that virtually all members of the community have in common. No two persons will be in complete agreement concerning the relative importance that should be

attached to various interests. Everyone will agree, however, that the scale of values the community accepts is of great practical importance. A community that attaches extreme importance to individual and group interests has great difficulty in developing policies designed to promote common interests. On the other hand, a community that attaches too great values to interests regarded as common may impose too complete conformity upon its members, and may limit its capacity to change and to adapt itself to new conditions.

Private enterprise may well cause men to attach more importance to individual and group interests than they would attach under some measure of socialism—though the controversies between the Coal Board and the employees in the British coal industry over installation of technological improvements and the division of the gains from them indicate that socialism does not prevent the growth of self-centered groups. It is the essence of the socialist indictment of private enterprise, however, that too great scope is allowed for the pursuit of private and group interests. The rapid growth of highly organized groups during the last several generations creates the danger that people will be trained to attach too great importance to group interests and will become narrow and parochial. Each person must reach his own conclusion as to whether or not he likes the kind of value judgments people are encouraged to make by the institutions of private enterprise. The danger that these judgments will be unduly narrow is real. The best protection against this danger is plenty of contact among persons from all manner of groups, good agencies of communication in the community, and a strong system of liberal education.

III

The American economy is a far better economy than most people realize. It is far more productive than most other economies; it is dynamic and progressive; it possesses great capacity to adapt itself to new conditions and to improve its methods and products; it has a multitude of points of contact with consumers, and does more than any other economy has ever done to discover the desires and whims of consumers; it is an economy in which there is broad participation in control, partly through democratic political processes, partly through millions of people who are in business for themselves and who run their own enterprises, and partly through the membership of millions of employees in trade unions.

The transformation of the American economy from a capitalistic to a laboristic society is occurring at a time when the United States has acquired a position of far greater economic importance in the world

than any other country has ever possessed. The transformation is also occurring at a time when the political and economic institutions of western Europe (and especially those of the United States) are being attacked through a carefully planned crusade organized by Russia. The object of this crusade is nothing less than the complete overthrow of Western institutions.

Will the new laboristic economy in the United States be able to give the world the kind of economic leadership it needs? Will it effectively stimulate growth of production? In particular, will it provide favorable conditions for innovators and pioneers? Will it keep production stable? Will it be able to champion effectively the institutions of freedom against the Russian efforts to destroy them? Will it be able to win new converts to freedom and eventually help the enslaved masses in Russia itself to win their freedom?

No one knows the answers to these questions. The new laboristic society will give other countries the kind of economic leadership they need provided it is good at increasing production and willing to increase imports. Although rapid technological progress in the United States has created serious problems for some countries, a great rise in output in the United States will help other countries, provided the United States increases its purchases as rapidly as it increases its output. Furthermore, a rapid economic progress in the United States reduces the danger of an attack by Russia, because it increases the potential military power of the United States.

Will the millions of employees who will be the most influential group in the laboristic society that is emerging appreciate their stake in a vigorous spirit of enterprise, in the rapid accumulation of capital, and in rapid technological progress? At present there is little evidence upon which to base either an optimistic or a pessimistic forecast. The ideas of employees are molded in large measure by trade unions, and the traditions of the trade-union movement in the United States are highly particularistic. Each union is pretty much concerned with its own affairs and its own problems, and feels little responsibility for the interests of labor as a whole. It is undoubtedly true, however, that employees as a whole have much to gain from effective policies for stimulating enterprise. The truth is powerful and one should not underrate its influence. Certainly it is at least probable that employees will discover their stake in enterprise and progress and that they will support public policies that foster enterprise.

In important respects the ability of the country to meet the challenge of Russia is improved by the shift of power from capital to employees. The participation of employees or their representatives in

policy-making means that new problems are seen sooner and more clearly, and that policies are based upon more complete information and better understanding of conditions. Likewise the participation of employees or their representatives in policy-making forces them to abandon their position of side-line critics and to assume their share of the responsibility for decisions—including their share of the inevitable mistakes. This is a wholesome condition. A regimented economy in which individuals are vassals of the state will have more difficulty in commanding the allegiance and confidence of the people than does a laboristic economy in which responsibility for basic policies is widely dispersed.

The new laboristic society that is emerging in the United States has an opportunity to build far better economic institutions than the world has ever seen. It has a chance to keep the best features of capitalism—the large number of enterprises and the considerable decentralization of decision making which keep industry in close touch with conditions, which make it flexible and adaptable, and which have been responsible in large measure for the tremendous dynamic drive of the economy. It has an opportunity to improve greatly on the institutions of capitalism by broadening the objectives of business policies, by introducing civil rights into industry, and by greatly widening the participation of the community in making public policies. It should be able to develop ways and means of keeping industry operating steadily without large ups and downs. Possibly it will succeed in opening the markets of the United States to the rest of the world and in developing far closer economic ties between this country and other countries. If the new laboristic economy can achieve these results, the rate of industrial progress attained under capitalism will be maintained and the standard of living should continue to double every forty years or less.

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WANTED: A NEW NAME FOR CAPITALISM

WILLIAM I. NICHOLS

THE REDEFINITION of just one word could help change history.

Finding a new term to express a new idea could be a decisive factor in checking the world spread of Communism.

This is the report that comes back again and again from men and women who are engaged in the struggle of ideas between the free world and the Soviets.

The word is "Capitalism."

It is the term used over and over by the Soviets as a smear word to describe our side; and, so far as that goes, Americans generally use it themselves when they try to describe our economic system. But in fact, and on both sides of the Iron Curtain, it is a misleading word; when applied to America, it no longer fits the system it pretends to describe.

What is worse, to many people it carries negative overtones of old errors and old abuses. In no other way does it imply the positive, dynamic, expanding system of today, constantly changing, but always moving toward one goal—to create more goods and greater well-being for more people.

Recently, a top official in our overseas information program put it in this way: "In all propaganda broadcasts now, the two words which appear most frequently are 'Communism' and 'Capitalism.' I don't think we have half as much trouble with the word Communism as we do with Capitalism. It's relatively easy to expose the bad side of Communism and make it stick—so much so that when you say 'Communism' and 'Red Fascism' most people know you're talking about one and the same thing.

"But," he went on, "It's nowhere near as easy to make the good side of our society plain by using the word Capitalism. That's important. We need a word to make people realize that the real source of hope, progress and prosperity rests with us."

The same thought has been expressed again and again by America's business leaders. "We only muddle our own thinking," they say, "when we use old words to describe new ideas."

To understand the problem, let's look back a bit. The word Capitalism came into being well over 100 years ago in the early days of the industrial revolution. At that time the basis of wealth shifted from land to money (that is, capital) invested in industrial and commercial ventures. Admittedly, during those years there were many abuses, errors and mistakes.

If you have read the novels of Charles Dickens—written 100 years ago—or the story of America's "Robber Barons" in the 1890's, you know what they were. There is no denying that Capitalism's primitive period contains many dark chapters of worker exploitation at home, and colonial expansion abroad.

WE'VE CHANGED

All those memories are contained in the word Capitalism. The Communists are clever enough to seize on that fact. Hence their use of the word Capitalist as a dirty name, a smear word, for every aspect of our Western civilization.

But what about us? Are we so stupid as to let them get away with it? In the face of their repressive, regressive slave system, we stand for a bold and imaginative society which has changed, developed and improved with the years. Are we imaginative enough to find a word for it?

Anyone who has eyes and looks around him knows how conditions today differ from those of 50 or 100 years ago. Here, for example, are ten points based in large part on a listing recently prepared by Edward J. Meeman, Editor of the *Memphis Press-Scimitar:*

1. Slavery, which antedates Capitalism, has been abolished in all Capitalist countries. In fact, and ironically, it is now practiced primarily in Communist countries, and on a wider scale than ever before in history.
2. In its early days Capitalism exploited the labor of women and children. This has nearly been abolished.
3. Capitalism once imposed overlong hours. These are now short, and growing shorter.
4. The standard of living under Capitalism has steadily risen. This

is exactly contrary to Marx's prediction—and to the record of Communist countries.

5. Unemployment has been reduced and controlled and is now a diminishing problem.
6. The adulteration and misbranding of products have almost been eliminated.
7. Early Capitalist employers cared little about the health and safety of their workers. Today industrial safety has been carried to such a point that more accidents occur in our homes than in factories, offices and stores.
8. The slogan of Capitalism once was "The public be damned." Today all progressive companies know the importance of public opinion, and public relations have become an essential part of management.
9. Capitalism formerly produced crowded, unsanitary slums. Now employers know the value of better living conditions, and work for them.
10. Imperialist wars were once waged by Capitalists and colonial rule imposed on foreign peoples. Now country after country has given up its colonies.

That is a pretty impressive list of differences between "then" and "now." And the process is still going on. Up to the time of emergency controls (a result of Communist aggression, by the way) company after company was developing new plans for bonuses, pensions, incentive wages, "cost-of-living" wage raises, profit-sharing and other procedures.

In one form or another all these methods are designed to give more and more people an increasing share of production, whether in the form of higher wages, shorter hours, lower prices or better goods and services.

Most of us in America know all these facts. We know what our "New Capitalism" is producing for us and what it can produce anywhere if given a fair chance. But hundreds of millions of people throughout the world don't know this. We must find some way to make clear in their minds the distinction between (1) our system and the Capitalism of the past, and (2) between our system and Capitalism as it is practiced in some other parts of the world. Unfortunately, there are still areas where Capitalism operates in the old, primitive way, and a Capitalist is regarded as a member of a privileged upper group who dodges taxes, exploits his workers and overcharges his customers.

EUROPE'S VIEW

As was pointed out recently by French-American writer Lewis

of what he knows about his own, and we have allowed him to remain in profound ignorance of the differences between the two."

A new name for our system would help make the distinctions clear. It would revive hope among the underprivileged. And at the same time it would be a spur toward more enlightened action by old-fashioned Capitalists wherever they may be.

Up to now Communism has claimed that it held out the only promise for a better future. But as soon as Communism takes over. the promises are forgotten. Then the Iron Curtain falls, the Security Police move in, the gates of the slave-labor camps swing open, and another helpless nation is trapped.

In a free world one can make no sweeping promises because people can come and go, and see for themselves. One can never claim that everything is, or will be, perfect for everybody, everywhere, at exactly the same time. But one can see with his own eyes that in most areas where true political and economic democracy is practiced, things are getting better; the direction is up. And it is the direction which counts.

CONTINUOUS IMPROVEMENT

How shall we describe this system—imperfect, but always improving, and always capable of further improvement—where men move forward freely together, working together, building together, producing always more and more, and sharing together the rewards of their increased production? Capitalism is no longer the right word. In too many minds it stands for the primitive economic system of the nineteenth century when, all too often, employers were greedy and workers were oppressed. We need a new name to describe the new, expanding, and ever-self-renewing system. What shall it be? I have heard various suggestions. Here are a few of the best:

The New Capitalism
Democratic Capitalism
Economic Democracy
Industrial Democracy
Distributism
Mutualism
Productivism

All have their points. All help catch and express the idea, or parts of it. But might there be something better? Some word which will catch hold and slip automatically into the language, giving that sense of birth, hope, promise and everlasting pushing forward which is the essence of every society of free men?

If we find the right word it will help things fall into perspective. Gradually, throughout the world, the word Communism will sink and dwindle to its true level, standing not for progress but reaction, not freedom but slavery, not comfort but miserable and abject poverty and fear.

The fact that no new name has yet been found shows that the problem is not easy. Perhaps we must still go through more years of effort and growth before the right word emerges. But some of *This Week's* 10,000,000 reader-families may come up with suggestions to push us further along the road. If so, they will have played their part in the battle for the minds of men.

* * * *

By May 13, 1951, *This Week* was able to print the following suggested terms. Some 5,654 of them had been sent in. Ultimately over 12,000 letters were received. Many writers wanted to avoid any word ending in an ism. Accompanying the list, the editors printed this comment: "Letters came from top business executives, from teachers and professors, housewives, ministers, filling-station operators, insurance salesmen, clerks, and dozens of other callings.

"Not all the letters were paeans of praise for America; not all the words were complimentary. But suggestions such as 'mutuality,' 'interdependence,' 'co-opetition,' and 'constructivism' indicated the direction of most thinking.

Advancism
Altruism
American Capitalism
American Democracy
American Humanism
American Individualism
American Progressivism
American System
American Way
Americanism
Americonomy
Balanced Economy
Beneficialism
Benevolent Capitalism
Brotherhood
Brotherism
Capablism
Capitalabor
Christian Capitalism
Christian Democracy
Christian Economy
Christianism
Christocracy
Civilism
Co-Capitalism
Co-Individualism
Collaborism
Collective Individualism
Collectivism
Commercialism
Commonwealth
Commonwealthism
Communityism
Competism

Competitism
Competitive Democracy
Competitive Economy
Competitive System
Constitutionalism
Constructionism
Constructivism
Contributism
Controlled Capitalism
Co-operation
Co-operative
Co-Opism
Co-Optimism
Corporatism
Creative Democracy
Creativism
Democapitalism
Democracism
Democracy
Democratic Economy
Democratic Enterprise
Democratic Freedom
Democraticity
Dividendism
Dynamicism
Dynamism
Dynamic U.S. Democracy
Economocracy
Economic Brotherhood
Economic Freedom
Economism
Enlightened Capitalism
Enterprise
Enterprise System
Equalism
Equalitarianism
Essentialocracy
Evolutionary Capitalism
Evolutionism
Expansionism
Fair Dealism
Fair-Sharism
Federalism
Financialism
Finandustry
Four Square System
Forwardism
Fraternalism
Free Americanism
Freedom
Freedomism
Free Enterprise
Freemanism
Free System
Futurism
Golden Rule Capitalism
Golden Rulism
Harmonism
Honestism
Humanism
Humanitarianism
Idealism
Improvism
Individual Enterprise
Individual Initiative
Individualism
Incentivism
Incentive System
Independence
Industrial Cooperation
Industrial Freedom
Initiative System
Initiativism
Interdependence
Investism
Investmentism
Justicism
Laborism
Liberal Capitalism
Liberalism
Liberatism
Liberatarianism
Libertyism
Lincolnism

Management
Manumission
Mass Capitalism
Mass Ownership
Meliorism
Meritism
Modern Capitalism
Modernism
Moral Progression
Mutual Benefit System
Mutual Enterprise
Nationalism
Naturalism
Objective Economy
Onward Together
Opportunism
Optimistic Democracy
Our Way
Ownership
Participationism
Partnerism
Partnership
Paternalism
People's Capitalism
Peoplism
Personalism
Plentyism
Productivism
Productive Democracy
Profitism
Profit Sharing
Profit System
Progressionism
Progressivism
Progressive Economy
Prosperism
Prosperitism
Providential
Publicism
Rationalism
Realism
Reciprocalism
Regulated Free Enterprise
Republicanism
Rightism
Rooseveltism
Samaritanism
Securitism
Servicism
Sharism
Social Individualism
Squaredealism
Teamism
Togetherism
Totaltruism
Unified Effort
Unionism
Unitism
Usacracy

APPENDIX: GOVERNMENTAL AGENCIES

ASHER B. ISAACS

It has been pointed out often that the Government of the United States has become a great deal more complicated than in the days of George Washington. It is true that President Washington got along with a small Cabinet consisting of a Secretary of State, a Secretary of the Treasury, a Secretary of War, an Attorney-General, and a Postmaster General. There was no Secretary of the Navy, no Secretary of the Interior, no Secretary of Agriculture, no Secretary of Commerce, no Secretary of Labor or any of the Departments which these positions suggest. Today our Federal Government not only has the Departments represented by the Cabinet positions but has a tremendous structure of "Bureaus," "Offices," "Administrations," "Authorities," and "Corporations." *The United States Government Organization Manual* which deals with the structure of our government is a book of some 650 pages. For the sake of convenience, many of the governmental agencies are called by alphabetical symbols, such as RFC for Reconstruction Finance Corporation. It is said that at the Pentagon in Washington there are some 1,500 approved abbreviations. There are quite a few agencies, however, for which the alphabetical symbols have not come into general use. There are many agencies concerned with defense and war. But there are many others concerned with business and other economic subjects. The following list covers most of those possessing economic significance, although since all agencies constitute spending units, it is hard to draw a sharp line. The list is alphabetical and is based upon the *Manual* referred to above.

ATOMIC ENERGY COMMISSION, 1946

Development and utilization of atomic energy toward improving the public welfare, increasing the standard of living, strengthening free competition in private enterprise, and promoting world peace.

BUREAU OF AGRICULTURAL ECONOMICS, 1923

Economic research and statistical agency of the Department of Agriculture. Acquires, analyzes, interprets, and diffuses useful economic information relative to agricultural production and distribution; land utilization and conservation in their broadest aspects; utilization of farm and farm products; purchasing of farm supplies; farm population and rural life; farm labor; farm finance, insurance, and taxation; adjustments in production to probable demand for different farm and food products.

BUREAU OF ANIMAL INDUSTRY, 1884

Prevention, control, and eradication of animal diseases and parasites. Research on the production of livestock and their products. Protection and development of poultry and related industries.

BUREAU OF THE BUDGET, 1921

To assist the President in the preparation of the Budget and the formulation of the fiscal program of the Government; to supervise and control the administration of the Budget; to aid the President to bring about more efficient and economical conduct of the Government service; to keep the President informed of the progress of activities by agencies of the Government.

BUREAU OF THE CENSUS

Fact-finding and statistical service agency of the Federal Government. Census of population and census of housing is taken every 10 years, in the years ending in 0; agricultural every 5 years, in years ending in 0 and 5; manufacturers and mineral industries, retail, wholesale, and selected trades every 5 years, covering the years ending in 3 and 8; governmental units, every 10 years, taken in years ending in 2. Certain data are collected monthly, quarterly, or annually.

BUREAU OF CUSTOMS, 1927

The assessment and collection of import duties; the prevention of smuggling, including the smuggling of contraband such as narcotics. In conjunction with other agencies, the Bureau enforces the preventive, sanitary, and other laws relating to imports, and in some cases outgoing articles. It handles the registry, enrollment, and licensing of vessels; admeasurement of vessels; collection of tonnage taxes; entrance and clearance of vessels and aircraft; regulation of vessels in the coasting and fishing trades; use of foreign vessels in the territorial waters of the United States; recording of mortgages and sales of vessels; protection of steerage passengers; inspection of all export declarations and permits.

BUREAU OF DAIRY INDUSTRY, 1924

Investigations in the breeding, feeding, nutrition, and management of dairy cattle with a view of developing more efficient dairy herds. Research on dairy products and dairy byproducts.

BUREAU OF ENGRAVING AND PRINTING, 1862

Designs, engraves, and prints for the Federal government currency, bonds, notes, bills and certificates; Federal Reserve notes; obligations of Government-owned corporations; revenue, customs, postage and savings stamps; Government checks and transportation requests; and other forms of engraved documents.

BUREAU OF ENTOMOLOGY AND PLANT QUARANTINE, 1935

Study of insects harmful or beneficial to agriculture and forestry with a view of finding methods of destroying the harmful ones and promoting increase and spread of beneficial ones. Development of insecticides. Exclusion of plant pests by border inspection. Control of insect pests and plant diseases.

BUREAU OF HUMAN NUTRITION AND HOME ECONOMICS, 1923

To meet the demand of American families for scientific facts to aid them in the best use of their resources, the Bureau conducts research on food, fiber, and other products of agriculture contributing to everyday living, and on economic problems, including housing and household buying, that affect rural families.

BUREAU OF INTERNAL REVENUE, 1862

The responsibility for the administration, assessment, and collection of all internal revenue taxes; the enforcement of the internal revenue laws, and the preparation and distribution of forms and instructions for the filing of income and other tax returns.

BUREAU OF LABOR STATISTICS, 1913

Successor to Bureau of Labor, 1884. Without enforcement or administrative functions, this Bureau collects data from workers, businessmen, and governmental agencies through voluntary cooperation based on their interest in and need for the analyses and summaries which result. Publishes *Monthly Labor Review* and special bulletins. Compiles and publishes indexes of wholesale and retail prices, rents, and consumers prices.

BUREAU OF LAND MANAGEMENT, 1946

Responsible for the management, protection, and disposal of the natural resources of unappropriated public and certain acquired Federal lands. The basic objectives underlying the program of the Bureau are the maximum use for the public interest of renewable resources on public lands consistent with conservation and development of productive capacity and the direction of the different uses of public lands so that the public may obtain the fullest benefits from each use.

BUREAU OF MINES, 1910

The conservation of mineral resources, the conduct of investigations on the mining, preparation, and utilization of mineral substances, and the promotion of safety in the mineral industries.

BUREAU OF THE MINT, 1873

Production of coin, medals of a national character and special medals for other Government agencies; custody, processing and movement of bullion; administers regulations for industrial gold in its natural state, including the issuance and denial of licenses, purchase of gold and the sale of gold bullion for industrial use; regulations on newly-mined silver.

BUREAU OF PUBLIC ROADS, 1949

Predecessor goes back to 1893. The principal road-building agency of the Federal Government. It administers large annual authorizations to aid the States in road construction as well.

BUREAU OF RECLAMATION, 1902

Conservation, development, and utilization of land and water resources of the West. Transformation through irrigation of dry lands into permanently productive farms; maintenance of production on lands threatened with retrogression to desert as a result of shortage of water. Facilities for the generation of hydroelectric power, drainage, flood control, improvement of navigation, silt control, stream regulation, municipal water supplies, and the creation of recreation facilities and wildlife refuges.

CIVIL AERONAUTICS ADMINISTRATION, 1938

Encourages and fosters the development of civil aeronautics and air commerce; civil airways, landing areas, and other air navigation aids and facilities; enforces civil air regulations; develops and directs the coordination of a national system of airports and directs the Federal Aid Airport Program.

COMMODITY CREDIT CORPORATION, 1933

A $100,000,000 corporation with authority to borrow $4,750,000,000. Its purpose is price support of agricultural commodities such as corn, wheat, rice, tobacco, cotton, peanuts, wool, mohair, tung nuts, honey, Irish potatoes, and milk and butterfat. It is also the procurement agency for agricultural products for the Government in its relief and related programs. The CCC can purchase abroad as well. It purchases and maintains granaries, makes loans for construction or expansion of farm storage facilities, and loans money to the Secretary of Agriculture for soil conservation.

COMMODITY EXCHANGE AUTHORITY, 1947

Known as the Grain Futures Administration from 1923–1936, and established as a separate agency again in 1947. To prevent price manipulation and corners affecting agricultural commodities; prevent dissemination of false and misleading crop and market information affecting prices; protect hedgers and other users of the commodity futures market against cheating, fraud, and manipulative practices; insure the benefits of membership privileges on contract markets to cooperative associations of producers; insure trust fund treatment of margin moneys and equities of hedgers and other traders and prevent the misuse of such funds by brokers; and provide information to the public regarding trading operations on contract markets. The Authority supervises trading on commodity exchanges designated as contract markets. There are 18 such markets. The commodities covered include wheat, corn, oats, barley, rye, flaxseed, grain sorghums, cotton, rice, millfeeds, butter, eggs, Irish potatoes, wool tops, cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, and fats and oils.

COUNCIL OF ECONOMIC ADVISORS, 1946

Assists the President in the preparation of his annual Economic Report to Congress; studies national economic developments and trends; appraises activities of the Federal Government bearing upon the Nation's economy and the advancement thereof; develops and recommends to the President national economic policies to foster free competitive enterprise and maintain employment, production, and purchasing power; and furnishes the President with such other studies and reports relating to Federal economic policy and legislation as the President may request.

ECONOMIC COOPERATION ADMINISTRATION, 1948

To furnish material and financial assistance to nations participating in a plan of European recovery, and which have signed bilateral agreements,

in such a manner as to aid them, through their own individual and concerted efforts, to become independent of extraordinary outside economic assistance within the period of operations under the act by promoting industrial and agricultural production, furthering the restoration or maintenance of the soundness of European currencies, budgets, and finances; facilitating and stimulating the growth of international trade.

EXPORT-IMPORT BANK OF WASHINGTON, 1934

A capital stock of $1,000,000,000 with borrowing power up to 2½ times this amount. To aid in financing and to facilitate exports and imports and the exchange of commodities between the United States or any of its territories or insular possessions and any foreign country.

FARM CREDIT ADMINISTRATION, 1916

Also subsequent amendments. Provision of a complete and coordinated credit system for agriculture by making long- and short-term credit available to farmers and farmers' cooperative marketing, purchasing, and business service organizations.

FARMERS HOME ADMINISTRATION, 1946

Provides supervised credit for farmers who cannot get the credit they need elsewhere at adequate terms and under reasonable conditions. Credit is supplemented where necessary by assistance to borrowers in planning and adopting sound farm and home practices which will promote success in farming.

FEDERAL COMMUNICATIONS COMMISSION, 1934

Regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all people of the United States a rapid, efficient, nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.

FEDERAL CROP INSURANCE CORPORATION, 1938

To improve the economic stability of agriculture; to develop a sound system of protecting the farmer's crop investment against production hazards over which he has no control. Protection of a crop investment at a premium rate designed to result over a period of years in premiums paid by insured farmers balancing with losses resulting from weather, insect infestations, or plant diseases. An authorized capital stock of $100,000,000. Coverage ultimately is to be extended generally to farmers throughout the nation.

FEDERAL DEPOSIT INSURANCE CORPORATION, 1933

Insures deposits of banks covered by the law; pays off the depositors of insured banks closed without adequate provision having been made to pay claims of their depositors; acts as receiver for all suspended national banks and for suspended state banks when appointed by state authorities; prevents the continuance or development of unsafe and unsound banking practices.

FEDERAL HOUSING ADMINISTRATION, 1934

Established to encourage improvements in housing standards and conditions, to provide a system of mutual mortgage insurance, and to exert a stabilizing influence on the mortgage market.

FEDERAL MARITIME BOARD, 1950

Control over rates, services, practices, agreements, charges, classifications, and tariffs of common carriers by water engaged in foreign commerce and persons engaged in forwarding or furnishing wharfage, dock, warehouse, or terminal facilities to such common carriers as provided in various federal laws. Makes investigations and determinations antecedent to the award of and awards ship-construction and ship-operating differential subsidy contracts for the purpose of placing United States ship-building and ship-operation on a parity with foreign construction and operation.

FEDERAL MEDIATION AND CONCILIATION SERVICE, 1947

In order to prevent or minimize interruptions of the free flow of commerce growing out of labor disputes, the service assists parties to labor disputes in industries affecting commerce to settle such disputes through conciliation and mediation.

FEDERAL POWER COMMISSION, 1930

Predecessor dates back to 1920. Effectuates the policy of Congress providing for the development and improvement of navigation and the development, transmission, and utilization of power on streams subject to Federal jurisdiction, upon lands of the United States, and at Government dams, by private and public agencies acting under licenses. Provides regulation of electric utilities engaged in interstate commerce.

FEDERAL RESERVE SYSTEM, 1913

To provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

FEDERAL SECURITY AGENCY, 1939

Established for the purpose of grouping under one administration those agencies of the Government the major purposes of which are to promote social and economic security, educational opportunity, and the health of the citizens of the Nation. It includes the Food and Drug Administration, Office of Education, Office of Vocational Rehabilitation, Public Health Service, Saint Elizabeth's Hospital, Social Security Administration (Bureau of Federal Credit Unions, Bureau of Old-Age and Survivors Insurance, Bureau of Public Assistance, and Children's Bureau), and certain federally aided corporations (American Printing House for the Blind, Columbia Institute for the Deaf, and Howard University).

FEDERAL TRADE COMMISSION, 1914

Also a number of later acts. To promote free and fair competition in interstate trade in the interest of the public through prevention of price-fixing agreements, boycotts, combinations in restraint of trade, unlawful price discriminations, and other unfair or deceptive acts and practices including false advertising; to safeguard life and health of the consuming public by preventing the dissemination of false advertisements of food, drugs, cosmetics, and devices; and to make available to the President, the Congress, and the public factual data concerning economic and business conditions as a basis for remedial legislation where needed, and for the guidance and protection of the public.

FISH AND WILDLIFE SERVICE, 1940

Conservation of the Nation's wild birds, mammals, fishes, and other forms of wildlife (both for their recreational and economic values), with a view of preventing the destruction or depletion of these natural resources, and to promote the maximum present use and enjoyment of the wildlife resources that is compatible with their perpetuity.

FOOD AND DRUG ADMINISTRATION, 1930

Predecessor goes back to 1907. Enforces Federal Food, Drug, and Cosmetic Act; Tea Importation Act; Import Milk Act; Caustic Poison Act; and Filled Milk Act. Promotes purity, standard potency, and truthful and informative labeling of the essential commodities covered by the provisions of these five acts.

GENERAL ACCOUNTING OFFICE, 1921

Performs an independent audit of Government accounts; in so doing, it exercises the power of disallowance based on the finality of the Comptroller General's settlement of accounts and claims, and reports to the Con-

gress in special and annual reports its findings as to financial conditions in the Government.

GENERAL SERVICES ADMINISTRATION, 1949

Responsible for assigning, regulating, or performing for executive agencies, as it finds advantageous in terms of economy, efficiency, or service, the functions pertaining to procurement, supply, and maintenance of real and personal property and nonpersonal services, including transportation and traffic and public utility services management; promotion of utilization of excess property; disposal of domestic surplus property; promotion of sound records management; and the preservation and administration of the permanently valuable noncurrent records of the Government.

GOVERNMENT PRINTING OFFICE, 1860

Executes orders for printing and binding placed by Congress and the departments, independent establishments, and agencies of the Federal Government; furnishes, on order, blank paper, inks, and similar supplies to all governmental activities; distributes Government publications as required by law, and maintains necessary catalogs and a library of these publications; prints, for sale to the public, such documents as are not of a confidential nature.

INLAND WATERWAYS CORPORATION, 1924

To further the policies affecting inland waterway transportation and make possible the coordination of rail and water transportation in the United States.

INTERSTATE COMMERCE COMMISSION, 1887

A number of subsequent acts as well. A body empowered to regulate, in the public interest, common carriers subject to the act engaged in transportation in interstate commerce and in foreign commerce to the extent that it takes place within the United States. As recently amended, all the provisions of the act are to be administered by the Commission in the light of a transportation policy added by the 1940 act, that all modes of transportation subject to its provisions are to be regulated so as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and

equitable working conditions—all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as by other means, adequate to meet the needs of the commerce of the United States, of the postal service, and of national defense.

NATIONAL BUREAU OF STANDARDS, 1901

The principal agency of the Federal Government for fundamental research in physics, mathematics, chemistry, and engineering. It has the custody of the national standards of physical measurement in terms of which all working standards in research laboratories and industry are calibrated. Improving methods for testing materials and equipment. Specifications for the purchase of Government supplies other than foods and drugs.

NATIONAL LABOR RELATIONS BOARD, 1935

Recognizing the right of employees to self-organization and to bargain collectively through representatives of their own choosing or to refrain from any or all such activities, this Board seeks to effectuate this policy by forbidding certain unfair labor practices and designates appropriate units for collective bargaining and to conduct secret ballots to determine the exclusive representative of employees.

NATIONAL MEDIATION BOARD, 1934

Established by the Railway Labor Act, the general purposes of this Board are to avoid any interruptions to commerce or to the operation of any carrier engaged therein; to forbid any limitation upon freedom of association among employees or any denial, as a condition of employment, of the right of employees to join a union; to provide for the complete independence of carriers and of employees in the matter of self-organization; to provide for the prompt and orderly settlement of all disputes concerning rates of pay, rules, or working conditions; settlement of grievances.

NATIONAL SECURITY RESOURCES BOARD, 1947

To advise the President concerning the coordination of military, industrial, and civilian mobilization, including policies insuring the most effective mobilization and maximum utilization of the Nation's manpower in the event of war; effective use of natural and industrial resources for military and civilian needs, for the maintenance and stabilization of the civilian economy in time of war; strategic reserves and their conservation; strategic relocation of industries, services, government and economic activities, the continuous operation of which is essential to the Nation's security.

OFFICE OF BUSINESS ECONOMICS, 1945

Basic economic measures of the national economy, current analyses of the economic situation and business outlook, the United States balance of international payments, and general economic research on the functioning of the economy. Basic economic and statistical indicators. National income and product analyses. Publishes monthly, *Survey of Current Business*. In the Department of Commerce.

OFFICE OF INTERNATIONAL TRADE, 1945

To foster and promote the foreign commerce of the United States. More specifically, its objectives are to promote United States trade interest in exports and imports in the interest of maintaining full production and full employment; to encourage and facilitate the expansion and balanced growth of international trade; to promote the stability of international economic relations; to cooperate with other nations in the solving of trade and exchange problems through international organizations and conferences and otherwise; and to reduce obstacles to and restrictions upon international trade. In the Department of Commerce.

PATENT OFFICE, 1802

Administers patent laws and the Federal trade-mark laws.

PUBLIC HEALTH SERVICE

Its origin dates back to a law in 1798 authorizing marine hospitals for the care of American merchant seaman. Its scope was broadened with the years until today it is the Federal agency specifically charged with the responsibilities for protecting and improving the health of the people of the Nation. It provides medical and hospital care for legal beneficiaries of the Service; assists other Federal agencies in health and medical programs for their employees and beneficiaries; seeks to prevent the introduction of communicable diseases into the United States; is concerned with water pollution, licensing of vaccines and serums; conducts scientific research on diseases of man; collaborates with other governments and with institutions concerned with health.

PUBLIC HOUSING ADMINISTRATION, 1947

Administers the low-rent public housing program authorized by the United States Housing Act of 1937 as amended.

PRODUCTION AND MARKETING ADMINISTRATION, 1945

Responsibility for programs relating to agricultural conservation, adjustment (including acreage allotments and farm marketing quotas), price

support and stabilization, foreign supply, school lunch, research, marketing services, and regulation.

RAILROAD RETIREMENT BOARD, 1935

Administration of a retirement system for the payment of annuities and pensions to aged and disabled railroad employees and annuities or other benefits to their survivors and a correlated unemployment-insurance–employment service system for paying unemployment, maternity, and sickness benefits to and securing the reemployment of railroad employees who become unemployed. The systems encompass the railroad industry of the United States as a functional and economic unit, and thus cover employees of carriers by railroad and express and sleeping-car operations subject to the ICC.

RECONSTRUCTION FINANCE CORPORATION, 1932

Aids in financing agriculture, commerce, and industry. Loans to encourage small business, helping to maintain the economic stability of the country and assisting in promoting maximum employment and production. Originally given a capital stock of $500,000,000 subscribed by the Government. Now $100,000,000, but similarly subscribed. Large borrowing powers. The act of 1948 authorized loans to any business enterprise for the purpose of production of prefabricated housing, or for large-scale modernized site construction.

RURAL ELECTRIFICATION ADMINISTRATION, 1935

Provides loans for financing the construction of rural electric facilities to serve rural people who do not have central station electric service. Such loans give preference to public bodies, cooperatives, and nonprofit or limited dividend associations. Loans are also used for rural telephones, wiring of farmsteads and the purchase and installation of electrical appliances and plumbing.

SECURITIES AND EXCHANGE COMMISSION, 1934

Protection of the interests of the public and investors against malpractices in the securities and financial markets. Public disclosure of pertinent facts concerning new security offerings and securities listed on exchanges; regulation of trading in securities on exchanges and in over-the-counter markets, to the end of eliminating abuse therein; integration and simplification of holding company systems of electric and gas utilities; supervision of activities of investment companies; regulation of activities of investment advisers; advisory services to courts in reorganizing proceedings for bankrupt corporations.

SOCIAL SECURITY ADMINISTRATION, 1935

Determination of policies and specific action in administering Federal old-age and survivors insurance and certifying to the Secretary of the Treasury amounts to be paid to entitled persons as monthly benefits or lump sums under that program; approving State plans for old-age assistance, aid to dependent children, and aid to the blind; other State programs.

SOIL CONSERVATION SERVICE, 1935

To bring about physical adjustments in land use that will better human welfare, conserve natural resources, establish a permanent and balanced agriculture, and reduce hazards of flood and sedimentation.

TENNESSEE VALLEY AUTHORITY, 1933

Bringing about an adequate and complete development of the Tennessee River system through the construction of a series of dams upon the main stream and its principal tributaries. A program of water control and conservation in the watershed of the Tennessee Valley. Fertilizer research is carried on at the plants at Muscle Shoals. The Tennessee basin covers about 41,000 square miles. Disposition of surplus power in the form of electricity is a major activity. Among the users are Alcoa and the Atomic Energy Commission at Oak Ridge, Tennessee.

TEXTILE FOUNDATION, INC., 1930

Created by Congress for scientific and economic research for the benefit and development of the textile industry and its allied branches, including that of the production of raw materials.

UNITED STATES EMPLOYMENT SERVICE, 1918, 1933

Maintenance of a farm placement service; a public employment service for the District of Columbia; assistance in establishing and maintaining systems of public employment offices in the several States; assistance in coordinating such systems throughout the country and increasing their usefulness by developing and prescribing minimum standards of efficiency; furnishing of information as to opportunities for employment; a system for clearing labor among the several states; employment of veterans.

UNITED STATES TARIFF COMMISSION, 1916

To investigate and report upon tariff and foreign trade matters including the effects of custom laws, tariff relations between the United States and other countries, commercial treaties, preferential provisions, and economic alliances. Surveys of industries, domestic and foreign costs of manufacturing, unfair competition in import trade. An agency in the Reciprocal Trade program.

WEATHER BUREAU, 1891

Predecessor 1870. Daily weather forecasts for agriculture, business, etc. Storm warnings, cold waves. Airways Weather Service, operating 24 hours each day. Frost warnings and spraying forecast advice in those States where fruit and vegetable production is a major activity. Marine meteorological service. Hurricane warnings. Flood warnings.

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Following are a few of the many international agencies in which the United States has an interest.

FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS, 1945

The United States and 62 other nations have agreed to further separate and collective action raising levels of nutrition and standards of living of the peoples under their respective jurisdictions, securing improvements in the efficiency of the production and distribution of all food and agricultural products, bettering the condition of rural populations, and thus contributing toward an expanding world economy. Through FAO the members will report to one another on the measures taken and the progress achieved in these fields of action.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, 1945

To make available from its own resources, or by other means, international investment capital for productive purposes. This task includes the guidance of such financing into rehabilitation, expansion, and modernization of industrial and agricultural facilities both in areas whose economies have been disrupted by war and in underdeveloped areas. By insuring that the funds employed and the projects so financed are used and developed on sound economic bases, the Bank seeks to promote an expansion in world trade in conjunction with establishment of equilibrium in balances of payments.

INTERNATIONAL LABOR ORGANIZATION, 1934

The date used here is the date on which the United States joined this organization which was created by the League of Nations at the end of World War I. Its purpose is to contribute to universal and lasting peace by furthering social justice. It seeks by international action to improve labor conditions, raise living standards, and promote economic and social stability.

INTERNATIONAL MONETARY FUND, 1945

To promote international monetary cooperation; to facilitate the expansion and balanced growth of international trade; to promote exchange stability and avoid competitive exchange depreciation; to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

UNIVERSAL POSTAL UNION, 1874

To establish a single postal territory for the reciprocal exchange of correspondence among the peoples of the various countries of the world and to assure the organization and improvement of the various postal services and encourage the development of international cooperation in this field.

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